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ABSTRACT

The Commission made an in depth study of the entire tax structure of Connecticut and developed a model for tax reform for the State that would allow for lessening of inequalities for many classes of taxpayers and create a more favorable climate for industry to increase employment for Connecticut people. This volume (the third of three) is in three parts. The first part reviews State-level taxation on individuals. It evaluates the impact of the sales tax, compares it to other States, and offers an alternative to the present 7 percent rate. A review of the need for a personal income tax is contained in this section, and recommendations against its adoption are presented. This first part also contains the Commission program for elimination of the tax on dividends, while increasing the tax on net long-term capital gains. The second part describes the need for business tax reform and offers programs designed to stimulate business expansion, retooling, modernization of equipment, etc.--all designed to create more jobs for Connecticut workers. The final part sets forth a variety of procedural reforms designed to simplify the revenue code and appeals procedures. (Author/JF)

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State of Connecticut

THE REPORT OF THE GOVERNOR'S COMMISSION ON TAX REFORM

Submitted to Governor Thomas J. Meskill

Pursuant to Executive Order 13 of 1972

VOLUME III — TAXPAYERS

People and Business

PART A — TAX REFORM FOR INDIVIDUALS

PART B — TAX REFORM FOR BUSINESS

PART C — PROCEDURAL REFORM

EA 005 593

HARTFORD, CONNECTICUT
December 18, 1972

This Report Consists of the Following:

SUMMARY OF COMMISSION REPORT

VOLUME I STATE FINANCE
Revenues and Expenditures

VOLUME II LOCAL GOVERNMENT
Schools and Property

VOLUME III TAXPAYERS
People and Business

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PART A

Tax Reform For Individuals

Introduction

The Commission's Report discusses the impact of taxation at various levels and singles out many classes of taxpayers for analyses. The purpose of this part is to examine the impact of taxation on individual taxpayers, and recommend specific relief.

In studying the Commission's recommendations concerning taxation and expenditures in Connecticut, the reader must consider its entire content and the interrelationship of the entire tax structure. Only by this process can the reader arrive at a reasonable conclusion as to whether implementing the recommendations will achieve the proper ultimate objectives of the tax program — one that is predictable and equitable for all classes of taxpayers, provides adequate revenues without recurring fiscal crises, does not have a negative effect on the economy, is easy to administer, and elicits straightforward compliance.

Meeting these objectives is of concern to Connecticut citizens particularly when it concerns so-called "taxes on individuals." However, no one should lose sight of the fact that **all taxes are paid by individuals directly or in the cost of goods and services purchased.** Nor should sight be lost of the fact that tax reform does not necessarily mean reduction or elimination of one type of tax and or imposition of or increase in rates of another type of tax. This type of "reform" often leads to the same taxpayer's paying the same amount of taxes, but under a different name (the "changing pocket theory"). It may also lead to rapid expansion of government spending as new and major sources of tax revenue are created.

Of course, no tax program can achieve the objective of absolute equality for every taxpayer and every income level. The impact of each tax depends too greatly on the individual circumstances of each taxpayer. Nor can a tax program be devised that will "shift the burden to the next guy" — every user of governmental sources must expect to assist in providing funds for these services. Nevertheless, the Commission's tax program for individuals reflects an effort to achieve the previously mentioned objectives to the fullest extent possible.

Findings and Recommendations

The Commission finds that

1. the State's sales tax, while seemingly high in gross rate (7%), is proportional rather than regressive due to the exemption of food. The tax is no more burdensome than that levied by many other states with lower gross rates due to lack of exemptions and additional local sales taxes in those states.

The Commission recommends that

A. the present 7% rate be continued, with an orderly program of reduction in the future as excess revenue develops. As an alternative, a reduction to 6½% can be effected if coupled with a broadening of the tax base to include certain items presently exempt. The base broadening should not disturb the present exemptions for food and medicine.

The Commission finds that

2. the present tax on dividends received by individuals is clearly a tax on income, as such is discriminatory as to income source, and falls heavily on income groups who must depend on dividends to meet current living costs. The nature of a capital gain, on the other hand, is not so clearly related to income and since realization is more often on the basis of investment decisions rather than current income needs, the tax on gains is not so burdensome.

The Commission recommends that

B. the 6% tax on dividends income of individuals be removed for income years beginning on or after January 1, 1973, and that the tax on capital gains be continued at a 6% rate on the entire net gain as determined for Federal purposes, without a 50% deduction.

The Commission finds that

3. a tax on real estate conveyances follows a well established pattern and applies to property

that, for the most part, does not change hands frequently, increasing the rate substantially from the present $1.10 per thousand should not be onerous in the present continuing trend of rapidly increasing real estate values.

The Commission recommends that

C. the present real estate conveyance tax rate be increased to $10 per thousand dollars of sale price with local governments retaining the present $1.10 and forwarding the balance to the State.

The Commission finds that

4. a personal income tax is unpopular with a large majority of the people of Connecticut, if enacted could open a new source of revenue for unnecessary future spending, and is not required in the Commission's balanced program. The State's present tax structure provides the necessary elasticity to meet expenditure requirements and can be made equitable without imposing an income tax.

The Commission recommends that

D. a Connecticut personal income tax should not be imposed.

Individual Taxation in Connecticut

At the state and local level, individual taxpayers are most aware of three types of taxes: property, sales and broad-based individual income taxes. Property tax reform is discussed in detail in Volume II, Part A of the Commission's Report. Of the two other major individual sources, Connecticut levies only a sales tax. On the national level the sales tax and broad-based income tax are levied as follows:

	No. of states
Sales tax	45
Broad-based income tax	40
Both taxes	34

The states of New Jersey and New Hampshire apply an income tax only on commuters from nearby states; three states tax selected investment income (Connecticut—dividends and capital gains; New Hampshire—dividends and certain interest; Tennessee—dividends and interest).

Two important factors in the study of the tax structure of state and local governments are its "elasticity" and whether it has "progressive-regressive-proportional" status.

Elasticity can be defined as the percentage change in tax yield per 1% of change in income. Thus an elasticity rate of 1.0 means that for every 1% of change in personal income within the state, the tax yield will change 1%. The elasticity of a particular tax, or the entire tax structure, can be measured with some certainty.

Elasticity of Connecticut's structure is discussed more fully in Volume I, Parts B and C. As discussed more fully in those parts "the elasticity of Connecticut's General Fund tax structure is calculated to be .90 which indicates that for every 1% growth of Connecticut's personal income, taxes will grow 9/10 of 1%." Using as a guide the ACIR elasticity study (Tables C-2 and C-3, Vol. I, Part C) Connecticut can be classified as having a medium elasticity, which is how Connecticut was defined by ACIR in 1967.[1] This classification is only an economic indicator and not of primary importance except as related to spending objectives.

There is, of course, no requirement that governmental spending rise as fast as personal income. As shown in the section on Projected Expenditure Volume I, Part C, the Commission anticipates a State expenditure increase of 5% per year through FY '77. Recognizing that the existing tax structure will increase at approximately 6.7% rate in each year, (see Vol. I, Part C, Revenues and Expenditures) the Commission believes that there is no further argument or desirability for improving elasticity of the Connecticut tax structure. While the present elasticity of .9 is somewhat less than an average for all states, the Commission believes it is sufficiently elastic to meet Connecticut's present and projected needs.

A tax structure can be defined as regressive if it takes a greater percent of personal income as the income level declines; the opposite situation is progressive. A tax is proportional when it takes

the same percentage of income from all income levels.

The question of the progressive, regressive, or proportional nature of the Connecticut tax system is discussed in detail in Volume I, Part B, "Tax Impact," of the Commission's Report. The issue is also discussed in Volume II, Part A, "Is the Property Tax Regressive?" from the point of view of impact of the property tax. These discussions have led the Commission to the conclusion that Connecticut's tax structure can best be described as proportional. **In view of the dominance of the progressive nature of the Federal tax structure, it is not necessary or desirable to attempt to create a progressive tax structure at the State level.**

In arriving at this conclusion the Commission was mindful of the total burden of State and local taxes. However, a factor as important as the current burden is that of fiscal effort, since certain measurements when calculated by themselves can be misleading. For example, two widely used measures of tax burden and capacity, taxes per capita and taxes per $1,000 of personal income, show diametrical results in Connecticut.

Taxes per capita for each of the 50 states show the per capita tax burden by state for the 11-year period 1960-61, 1965-66 as the mid-point, and 1970-71. The per capita State and local tax burden for Connecticut in 1960-61 was $222.72, ranking Connecticut 16th among all 50 states. In 1965-66, Connecticut ranked 13th nationally, and by 1970-71 per capita taxes grow to $533.19, ranking Connecticut 7th among all states. This measure shows Connecticut to be not only high in its tax burden relative to other states but growing higher over the last decade.

However, another measure of tax effort, taxes per $1,000 of personal income, shows that Connecticut ranked 43rd among all states in '60-61, 46th in '65-66, and 32nd in '70-71. While Connecticut has been increasing its effort by this measure, it has consistently ranked at the opposite end of the scale compared to taxes per capita. The per capita tax measure shows Connecticut high in its tax effort, whereas the per $1,000 of personal income measure indicates that Connecticut has not even come close to reaching its taxing capacity.

The true measurement of the Connecticut State and local tax effort is somewhere in between. The U. S. Advisory Commission on Intergovernmental Relations (ACIR) concluded that the Connecticut State tax effort was below the national average, but that local effort was above the national average (see Vol. I, Part B, pages 30 to 37, for more detailed discussion).

While there may be some dislocation of tax burden by taxpayer groups, the Commission is of the opinion that the overall tax burden of various individual groups is generally fair and that drastic changes are not necessary. In addition, Commission recommendations discussed elsewhere in the Report will go far to correct the most serious of these dislocations without burdening Connecticut's citizenry with significant new types of taxes.

Connecticut Sales Tax

A frequent comment about Connecticut's sales tax rate of 7% is that it is the highest in the country. **While this is true if one compares only gross rates, it is not true in an "effective rate" comparison, which would consider the fact that many other states permit local governments to levy a sales tax in addition to the State tax.** Another important factor in arriving at an "effective rate" is the exemptions from the tax that a jurisdiction permits.

Connecticut's sales tax rate will compare very favorably when these factors are considered:

		Exemptions				
	Local sales tax levied	Food	Prescription medicine	Clothing	Utility services	Heating fuel
Connecticut	No	Yes	Yes	Yes*	Yes**	Yes
44 Other States	22	18	28	5	15	11

* Through age 9.

** First $10 per month.

The effect of these factors is demonstrated by the fact that for all 50 states per capita sales tax revenue at the state level was $75.29 in 1971 while Connecticut's was $86.08.[2] On a tax revenue per $1,000 of personal income in 1971 the 50 state average was $19.47 while the Connecticut average was $17.94.[3] If locally assessed sales taxes in many other states were added to these amounts, Connecticut's comparative sales tax burden would be even less.

Another example of the favorable effective sales tax rate in Connecticut can be derived from "optional sales tax tables" prepared by the Internal Revenue Service for 1972 individual income tax returns. For example:

		Family of 4 with adjusted gross income of		
	Sales tax rate	Under $3,000	$5,000 to $5,999	$10,000 to $10,999
Connecticut	7%	$49	$94	$161
Illinois*	4%	$92	$144	$208
New York**	4%	$53-93	$90-158	$139-244

*Additional local rates up to 1% included.

**Plus local rates of up to 3% — amounts show range from 0 local tax to the maximum 3% (approximately 85% of the property is subject to the 3% local rate).

Illinois has no exemption for food, etc.; New York has no exemption for clothing, utilities, and heating fuel.

Another comment concerning the sales tax is that it is regressive. This is a question which involves difficult definitions and for which it is hard to obtain objective conclusions. In addition, the question of regressivity depends on the entire state and local tax structure. As discussed in this section under "Connecticut's Tax Structure," the Commission is of the opinion that the state's structure can best be described as proportional.

With respect to the total reliance of a state and local tax structure on the sales tax, it has been recommended that "The general sales tax should serve as the other major state tax capable of producing between 20 and 25% of state-local revenue without imposing an extraordinary burden on low income families—the exemption of food and drugs or the provision of income tax credits can go a long way toward pulling most of the regressive stinger from this tax."[4] Connecticut's reliance on the sales tax was 17.6% in 1970.[5] While probably somewhat higher now, it should be well within a recommended limit, even without an individual income tax.

The progressive feature of the food exemption such as Connecticut's on a sales tax is demonstrated by a study which showed that food represented 34% of the budget of low standard families, 29% of moderate standard families, and 26% of higher standard families.[6]

Nonetheless, the Commission recognizes that many people feel the sales tax is too high. The differential between Connecticut and its neighbors has also proved to be a burden to retailers with stores near the state borders. Shoppers disregarding the Use Tax aspects of the general sales tax take advantage of the lower rates prevailing across the borders and thereby place certain Connecticut retailers at a competitive disadvantage.

Program for Reduction

The Commission offers the following alternative to continuing the sales tax at its present 7% rate: beginning in 1974, the general sales tax can be reduced to 6½% and the base of the tax broadened to include children's clothing and personal services.[7]

Children's clothing has been an exemption difficult to administer in the past because of the problem of estimating ages and clothing styles. Lowering the age to 10 years was helpful in minimizing this problem, but it still continues. The "Twelfth Report of the New Jersey Commission on State Tax Policy" presented information to show that the clothing exemption, on a per capita basis, is estimated to be more than twice as great for the $10-15,000 income group as for the $4-5,000 group, thereby adding a degree of regressivity to the sales tax.

The addition of personal services will also have the effect of making the sales tax less regressive since low income groups spend less on personal services than do higher income groups. Removing these exemptions should make the sales tax more equitable without increasing its overall burden to residents of the State.

As excess revenues develop in the next five years (see Part D, Volume I for a prediction of excess revenues through FY '77) **the Commission recommends the sales tax be reduced.**

An orderly program for reduction of the general sales tax would lead to a ½ point reduction in FY '76 and an additional ½ point reduction in FY '77.

Tax on Dividends and Capital Gains

Legal Issues

In 1969 the Legislature enacted a law taxing individuals with capital gains in excess of $100 at a rate of 6%; net gains were computed the same as under Federal law, including a deduction for one-half of net long-term gains. As originally enacted, gains received between July 2, 1969 and June 30, 1971 were to be taxed.

In 1971 the Legislature enacted the so-called "investment income tax," which amended the 1969 law to apply to capital gains only through December 31, 1970. The 1971 Act imposed a 6% tax on capital gains and dividends received by individuals after December 31, 1970. Capital gains are again to be computed for the most part under Federal rules, with a major exception — the State Tax Commissioner interpreted ambiguities in the 1971 Act to permit taxing the entire capital gain, without the 50% Federal deduction for net long-term gains.

Both the 1969 and 1971 Acts are now under court attack by taxpayers. As to the 1969 Act, several cases are testing a number of issues; other than the Constitutional questions of due process and equal protection, the principal issue is whether the basis for gain or loss on assets held at the effective date of the statute should be July 1, 1969, fair market value, or the Federal basis which may reflect an earlier value. One of these cases has been decided adversely for the taxpayer by the Connecticut Supreme Court. The only appeal of the decision would be to the U. S. Supreme Court. The other 1969 cases are in a holding pattern pending the outcome of litigation relating to the 1971 Act.

The case challenging the 1971 Act also presented the Constitutional and basis step-up issues, and in addition attacked the singling out of dividends for the tax while excluding interest and other investment income, and the denial of the 50% net long-term gains deduction. On August 8, 1972, the Connecticut Supreme Court decided against the taxpayer on the various issues except for interpreting the Act to permit the 50% deduction from net long-term gains. The case is in the process of appeal to the U. S. Supreme Court on the issues of basis step-up and singling out dividends to tax.

Collections under 1969 and 1971 Acts are as follows (the one-half 1969 year is omitted):

Individuals taxable year*	Capital gains	Dividends	Total
1970	$10,300,000		$10,300,000
1971	$34,300,000	$25,800,000	$60,100,000

*All but a small majority of individuals file on a calendar year basis.

Approximately one-half ($17,000,000) of the 1971 capital gains collections will be refunded under the above-mentioned court decision.

Basis for Elimination of Dividends Tax

The Commission has concluded that the tax on dividend income should be removed for income years beginning on or after January 1, 1973. As discussed elsewhere in this report, the Commission has also recommended that a Connecticut personal income tax not be imposed. Since the tax on dividends is clearly a tax on income, it is discriminatory when compared to all income, as well as when compared to other investment income. Another reason for the Commission recommendation is that the tax often falls on those least able to pay it — those in low income brackets and particularly elderly individuals who have invested in stock to provide the necessary retirement income. In excluding interest income from taxation under the 1971 Act, the Legislature was mindful of the number of Connecticut citizens not in the higher income brackets who receive and depend on interest income. On the basis of information available as to the increasing number of shareholders in this country, the Commission is persuaded that this reasoning is more and more applicable to dividends.

Tax Gains at Full Value

The Commission has, however, recommended changing the capital gains tax to a rate of 6% on the entire net capital gain as determined in Federal Income Tax purposes (elimination of the 50% deduction). It should be pointed out that the net effect of these two recommendations will be to relieve Connecticut taxpayers of $9,000,000 in taxes (reduction of $26,000,000 in the tax on dividends and $17,000,000 increase in the tax on capital gains).

The Commission is aware of the many arguments concerning the nature of a tax on capital

gains; for instance whether it is in fact a tax on intangible property vis-à-vis a tax on income, and the arguments on taxing only a part of the gain. It is also aware of the fact that some other states do tax capital gains of individuals at higher rates than certain other types of income.

This recommendation must be viewed as part of the entire report which balances revenues against needs and provides tax relief where possible to assist the greatest number of citizens. **It would appear that capital gains are for the most part realized on the basis of investment decisions. Dividends, interest, etc. are often depended upon for the necessities of life. Individuals realizing capital gains under this premise are more able to pay a tax on that gain from the proceeds.**

The Commission feels that capital gains could more appropriately bear the burden of a tax than other types of individual income. It can see no reason to follow the Federal rule for a 50% reduction in certain types of gains since the State tax rate is so much lower.

While all existing taxes on income at the Federal and State levels contain some discriminatory provisions, these recommendations will provide substantial relief from the existing legislation. The only alternative aside from complete elimination of the tax (which is unsatisfactory with respect to revenue requirements) *is to tax all income at a lower level.* This is not recommended for other reasons as discussed in the section on the personal income tax.

Real Estate Conveyance Tax

The real estate conveyance tax has been levied for many years. Until 1967 it was a Federal tax at the rate of $1.10 per thousand dollars on the equity portion of the sales price only. It did not, for example, include assumed mortgages. The Federal law was repealed to be effective in 1967; simultaneously, Connecticut enacted a similar law. The one principal difference in the Connecticut law required the tax be levied at the rate of $1.10 per thousand dollars to total sales price including assumed mortgages or any other equity value in addition to cash. Income from this source is retained by the local municipality.

Thirty-seven states levy a real estate transfer tax at the state and or local level. The tax follows a well-established pattern, and is easy to administer. It applies, for the most part, to property that does not change hands frequently.

This Commission recommends the conveyance tax rate be increased from $1.10 per thousand dollars to total sales price to $10.00 per thousand dollars of total sales price (1%). Local governments would retain the present $1.10 and forward the balance to the State. This will produce an estimated total revenue of $18 million at the State level.

The proposed rate is substantially higher than that imposed by most of the other 36 states with a real estate conveyance tax. However, the Commission does not feel that the proposed rate is onerous in view of the continuing trend of rapidly increasing real estate values.

Personal Income Tax

A Connecticut personal income tax was recommended by the Connecticut State Revenue Task Force in its February 11, 1971 Report and by the Governor's Strike Force for Full Employment in 1971. The Task Force recommended a 20% surcharge tax on Federal income tax liability (piggyback tax). It was designed to raise approximately $400 million based on 1970 estimates of personal income.

The Strike Force recommendation was a proportional tax at 3% on adjusted gross income, to raise $385 million based on a 1971 estimate of personal income. The Strike Force recommended a tax on Federal adjusted gross income with limited adjustments and with a $1,000 personal exemption for each taxpayer and dependent for simplicity of administration and the ability of every taxpayer to easily calculate his own tax.

Both the Revenue Task Force and the Strike Force felt it was necessary to recommend a personal income tax in order to achieve the revenues needed by the State government. Both Commissions designed a tax model to be responsive to a minimum of 10% incremental expenditures each year. Both Commissions felt that the additional revenues from the personal income tax were necessary in order to make any measure of tax reform possible and in order to relieve existing inequities and special burdens on certain taxpayer classes.

The attitude of the Revenue Task Force towards a personal income tax is set forth on page 22 of its Report:

> "Therefore, there being no other acceptable means for raising the required revenue, it is with regret and a sense of nostalgia that the Task Force reports that it has no choice but to recommend the adoption of a personal income tax for Connecticut."

As shown in the section on Projected Expenditures, Vol. I, Part C, the Commission anticipates that State expenditures will increase only 5% a year through FY '77. In view of this estimate the **Commission is of the opinion that a new tax is not necessary to raise sufficient revenues for present and projected State spending.** In addition the Commission believes there are other persuasive reasons for not imposing an individual income tax on Connecticut:

1. The questions of "elasticity" and "progressive-regressive-proportional" aspects of a state's tax structure have been discussed elsewhere in the Report. The Commission is of the opinion that an overall proportional structure is created by the balanced program it recommends, without an individual income tax.

2. **There is no merit to the argument that Connecticut should have a personal income tax, whether it needs it or not, just because 40 other states have one.** We are not aware that other states have mitigated recurring problems concerning revenues and expenditures by enacting individual income taxes, or that Connecticut's problems have been more severe without such a tax.

3. **The Commission is concerned that imposing a new tax would open up another source of revenue** which could lead to unnecessary spending with, at the most, temporary rate reductions in other types of taxes. It is interesting to note that in 1970-71 7 states increased their sales tax rates, while 17 increased personal income tax rates.

4. **A personal income tax could have an adverse effect to Connecticut on business location decisions.** Volume III, Part B, discusses business taxation in Connecticut and presents a program designed to promote business activity in the State, with related increased employment. Absence of a State individual income tax is a positive factor to corporate officials in making location decisions.

5. Many Connecticut taxpayers have been subjected to increased taxes on their earnings in 1972 through increased Social Security payments. Further increases are scheduled for 1973 and 1974.

6. The majority of the State's citizens do not want an personal income tax. This has been demonstrated by their immediate and forceful reaction to the Legislature's attempt to impose such a tax in 1971. Members of the General Assembly were quick to realize the strength of this reaction by immediately repealing the tax. Public opinion polls in the State have reaffirmed this view of public opinion.

The Commission held four public hearings throughout the State, at which a number of advocates of an individual income tax in Connecticut appeared and testified. Many of these advocates proposed special tax relief for interests which they represented requiring additional new revenue sources; others proposed individual rate structures that would have excluded or provided minimal taxes for the most part for the groups they represented. However, the most numerous of those attending the hearings advocated fiscal responsibility in spending without new or increased taxes, and spoke as individuals. The Commission considered opinions expressed at the public hearings along with the other factors discussed here.

For the reasons discussed above, the Commission recommends that an individual income tax not be imposed on Connecticut taxpayers.

FOOTNOTES TO PART A

1 In general, state tax structures which rely primarily on income taxes have an elasticity of 1.2 or greater; those relying on a sales tax or a combination of sales and income taxes, close to 1.0; and those relying on sales and excise taxes, less than 1.0. See ACIR, *Fiscal Balances in the American Federal System* (Washington, D.C., 1967).

2 U.S. Dept. of Commerce, *State Government Finances* (1971), p. 11.

3 *Ibid.*, p. 18.

4 ACIR, *State-Local Finances: Significant Features and Suggested Legislation* (Washington, D.C.: U.S. Government Printing Office, 1972).

5 *Ibid.*, p. 4.

6 "Three Standards of Living for an Urban Family of Four Persons (in Spring, 1967)," U.S. Dept. of Labor, Bureau of Labor Statistics, Bulletin 1570-5 (1969).

7 Repairs and alterations, printing, photography, laundry, dry cleaning, barber and beauty shop services, and parking.

PART B

Tax Reform For Business

Introduction: Objectives of State-Local Business Taxation

The benefits of economic activity and growth accrue to all through increased employment. Government services are supported by taxes which are paid from the rewards of private productive economic activity, rewards derived from the employment of economic resources. Business activity provides this employment. Every effort, therefore, must be made **to insure maximum employment through the maintenance of a favorable environment for the location of new industry in Connecticut and the expansion of existing investment and job opportunities in Connecticut's business sector.**

Business tax reform may easily have as many meanings as there are reformers. This is particularly true in the absence of agreement on the objectives of State-local business taxation; but even if agreement could be achieved, there would be differences among reasonable and informed observers as to how these objectives might be maximized. Thus, although the Commission's specific program for Connecticut business tax reform may not meet with universal approval, it is designed to resolve the most serious major issues.

Connecticut must have a tax structure which will assure a healthy State economy characterized by high employment and income levels that come from the attraction, retention, and expansion of business and industry in the State, and a tax structure which meets the revenue needs of State and local governments. It is incumbent upon the State, therefore, to provide such a climate by insuring the economic growth of its business and industry which provide 86% of all jobs in the State and are vital to the State economy.

Corporations faced with what they regard as a burdensome tax structure in one state where it maintains a facility may shift much if not all of those facilities to another corporate installation located in a state with a more favorable tax structure. Such relocation results in loss of revenue and jobs within the state.

Connecticut business has, on balance, been moving out.

Manufacturing employment in Connecticut during the period since 1960 has declined 1.6% while on the national level it has increased 10.8%.

Had Connecticut maintained its growth at the national rate it would have meant a 50,000 increase in manufacturing jobs over our present level and due to the multiple effect (creation of additional jobs in construction, retail, service, and government) an overall increase of over 100,000 jobs.

Connecticut for many years ranked number one in the nation in the percentage of manufacturing jobs to total employment. In the past three years our ranking has dropped to number five and has every indication of going lower. The blame does not rest solely on the reduction in government spending and defense goods, but includes the departure or liquidation of some of our plants. **It is less costly, in tax terms, for companies to operate in some of our neighboring states than it is in Connecticut.**

Summary of Findings and Recommendations

General Findings

The tax structure in Connecticut is frequently not competitive with that of other states, resulting in many location decisions being adverse to a Connecticut location.

Certain changes are necessary in Connecticut's taxation of business to assist in providing the climate necessary to (1) encourage existing businesses to expand within the State rather than looking elsewhere, (2) mitigate factors encouraging business to move from the State, and (3) attract new business from without the State.

Significant taxation occurs at the time of investment in Connecticut, acting as a negative factor in attracting investments into the State.

Specific Findings and Recommendations

Sales Tax on Machinery and Equipment

Finding: *The sales tax on manufacturers' and farming machinery and equipment is a deterrent to investment and should be eliminated.*

Recommendation: *This tax should be eliminated in two stages: a 50% reduction effective July 1, 1973, and the balance eliminated July 1, 1976.*

Tangible Personal Property Tax

Finding: *Taxes on tangible personal property of businesses are a substantial deterrent to expansion of business within Connecticut. The levy, in taxing investment instead of profitability of the business, also discourages expansion and modernization of facilities, and the manufacturing and maintaining of inventories within the State.*

Recommendation: *New purchases of manufacturers' machinery and equipment, furniture and fixtures, and all other personal property except motor vehicles, rolling stock of contractors, airplanes, and the personal property of public service companies[1] should be exempt from the personal property tax.*

Corporate Business Tax on Income

Finding: *While Connecticut's corporate income tax rates among the highest of all states, the Commission does not consider it necessary to reduce the rate to remain competitive with other states, in view of the balance established by other proposals. However, it is necessary that the State law be changed in certain respects.*

Recommendations:

It is recommended that the Connecticut corporation net income tax be amended to conform to the Federal law in permitting the carry forward of operating and capital losses. The current prohibition in the Connecticut statutes on the carryback of certain losses should be continued.

It is recommended that the Connecticut corporation net income tax be amended to conform to the Federal law in permitting the filing of consolidated tax returns where such returns are filed for Federal purposes.

It is recommended that the current phase-out program for the deduction of interest paid from taxable income be continued to its programmed elimination in 1976 for financial institutions and 1974 for other corporations.

It is recommended that the alternative 4 mill tax on capital and debt be replaced by a minimum alternative franchise tax measured by issued and outstanding corporate shares; the present minimum alternative tax applicable to investment funds, banks, and other financial corporations, and the $45 minimum charge would be retained. An immediate study of another form of alternative minimum tax for financial institutions is recommended.

The Insurance Industry

Finding: *The Legislature has recognized that domestic insurance companies have been subject to discriminatory taxes and has provided for elimination of the tax on dividends and interest and for an adjustment of the tax rate on insurance premiums.*

Recommendation:

It is recommended that insurance companies be made subject to the corporation net income tax provisions of the Connecticut corporation business tax.

Recommendation:

Payments to local government by the State in lieu of property taxes on manufacturers' or merchants' inventories should be eliminated upon implementation of the recommendations for uniform assessments as contained in Part C, Volume II. (See also Part A, Volume II for analysis of impact on certain communities.) The projected year for full implementation of the assessment reforms is FY 1976.

Payments in lieu of property taxes on new purchases of manufacturers' machinery and equipment and other categories recommended for exemption are not provided for because the Commission's analysis of overall revenue to local government indicates an increase each year over the four-year period 1974-77, and consequently, grants in lieu of taxes will not be required. (See Part A, Volume II, for summary analysis of the total impact of the Commission's program for local government.)

The Current Tax Situation: An Overview

The major taxes currently paid by business in Connecticut are the local property taxes (on land, buildings, machinery, equipment, tools, and other personalty), the State's corporation business tax, insurance and utility company taxes, and the sales or use tax on business purchases. Some $620 million of State-local tax receipts is attributable to these sources (exclusive of motor fuels, licenses, and unemployment compensation taxes), or $570 per non-agricultural employee in the State per year.[2] Of this sum, approximately two-thirds, about $450 million, represents taxes that do not vary with output or income in the short run, but rather represent a more or less fixed cost to the operation. To businessmen concerned with "break-even" points, such costs require increased sales volume before those "break-even" points can be achieved.

Taxes are a cost of doing business, and today's hard-pressed corporate managers must take them into account when planning expansion, locating new facilities, or relocating present facilities. While many other factors impinge on the choice of location for a business, tax costs (considerably higher in Connecticut than in many other states) can influence many decisions to locate out of State. Perhaps equally important to the level of business taxes is the structure of business taxation. Where differences in form rather than substance are permitted to influence tax liabilities, adverse reactions to these liabilities are particularly intense.

Any examination of business taxation in Connecticut requires attention to practices in other states, particularly those which are considered closely competitive. What objective evidence exists points to the conclusion that business and industry in Connecticut are subject to heavier taxation than in competing locations. In a recent report published by the Federal Reserve Bank of Boston, Connecticut was included among the "highest tax" states for representative manufacturing firms in the Northeast.[3]

While it is popular for legislatures and the general populace to shift tax burdens to business and industry, the result can lead to loss of industry and jobs. It is an absolute fact that many businesses are free to choose where they locate and their managements are considered derelict when they choose to stay in a costly environment when other satisfactory choices are available. It is important, therefore, that we in Connecticut provide at a minimum, a neutral tax climate, one which makes taxes neither high nor low with respect to competing states.

Although the current status of Connecticut State-local taxation is important, perhaps a more relevant consideration from the point of view of long-range investment planning is recent trends in the level of business taxation. According to data compiled by the Federal Advisory Commission on Intergovernmental Relations (ACIR), business tax payments of all states and localities rose from $9.8 billion to $17.9 billion over the 10 year period, 1957-67.[4] Despite this impressive increase in absolute business tax liabilities, *the relative reliance on the business sector for State-local tax revenues declined from 34.2 to 29.3%*. Table B-1 gives the relationship of State-local taxes paid by business to total State-local taxes, by state for the years 1957, 1962, and 1967.

In 1957, State and local governments in Connecticut called upon the business sector to provide an estimated 32.6% of their total tax revenue. Ten years later, the figure was 31.4%, a 3.7% decline. In contrast, the all-State average percentage decline in relative fiscal importance over the same period was 13.6%. Forty states listed percentage *reductions* in business taxes in excess of Connecticut's. Included among these 40 states with their corresponding percentage reductions are New York (11.6), Rhode Island (14.8), Massachusetts (21.1), Pennsylvania (26.2), and New Jersey (29.7). In a word, *all states in fairly close proximity to Connecticut in terms of comparable locational characteristics recorded substantially higher reductions in their reliance on the business sector for the support of state-local services.*

Table B-2 shows the 1968, 1970, and 1971 breakdown of business/total tax payments for Connecticut State tax payments only. *On the basis of this computation, for the most recent year, the State of Connecticut ranked fourth from the highest among the states in its relative reliance on business taxes.* In a real sense, Connecticut ranked at or near the top, for the 3 states listed higher than Connecticut (Alaska Louisiana, and Delaware) have unique business tax situations. All have so-called "captive" audi-

TABLE B-1: Relationship of State and Local Taxes With an Initial Impact on Business to Total State and Local Taxes, by State, 1957, 1962, and 1971[1]

(Dollar amounts in millions)

STATES	Total State and local taxes			State and local taxes on business			Taxes on business as % of total taxes			
	1967	1962	1957	1967	1962	1957	1967	1962	1957	% change 1957-1967
United States	$61,000.3	$41,554.2	$28,645.1	$17,853.4	$13,329.9	$ 9,791.7	29.3	32.1	34.2	−13.6
Alabama	677.4	436.7	318.4	154.6	106.7	82.8	22.8	24.4	26.0	−12.3
Alaska	85.8	52.4	N/A	23.5	16.1	N/A	27.4	30.7	N/A	N/A
Arizona	523.7	328.0	182.6	139.4	98.5	59.7	26.6	30.0	32.7	−18.7
Arkansas	392.5	254.8	177.5	82.1	58.6	47.3	20.9	23.0	26.6	−21.4
California	7,785.2	5,142.9	3,304.0	2,391.0	1,637.5	1,082.7	30.7	31.8	32.8	− 6.4
Colorado	677.7	475.7	313.2	190.8	148.1	98.2	28.2	31.1	31.4	−10.2
Connecticut	**982.6**	**684.0**	**460.8**	**308.2**	**234.3**	**150.4**	**31.4**	**34.3**	**32.6**	**− 3.7**
Delaware	177.6	112.3	58.6	51.2	34.3	16.3	28.8	30.5	27.8	+ 3.6
Dist. of Col.	274.9	183.0	142.7	78.7	55.0	44.3	28.6	30.1	31.0	− 7.7
Florida	1,623.1	1,061.3	663.3	416.0	330.3	214.9	25.6	31.1	32.4	−21.0
Georgia	1,025.0	627.4	467.9	256.3	167.4	118.7	25.0	26.7	25.4	− 1.6
Hawaii	300.5	173.8	N/A	48.0	30.1	N/A	16.0	17.3	N/A	N/A
Idaho	205.2	136.4	99.8	62.2	46.0	34.4	30.3	33.7	34.5	−12.2
Illinois	3,249.6	2,461.9	1,723.7	804.2	683.4	516.4	24.7	27.8	30.0	−17.7
Indiana	1,471.3	951.1	635.3	399.2	363.5	236.5	27.1	38.2	37.2	−27.2
Iowa	918.9	638.3	487.6	170.0	139.9	96.8	18.5	21.9	19.9	− 7.0
Kansas	717.1	518.6	367.4	185.7	149.3	109.3	25.9	28.8	29.7	−12.8
Kentucky	674.2	466.8	323.1	136.4	111.7	93.9	20.2	23.8	28.9	−30.1
Louisiana	958.8	655.1	497.2	488.8	348.9	238.8	51.0	53.3	48.0	+ 6.3
Maine	253.2	197.3	140.0	63.4	51.6	40.5	25.0	26.2	28.9	−13.5
Maryland	1,172.4	713.8	460.2	291.9	189.3	132.3	24.9	26.5	28.7	−13.2
Massachusetts	2,004.2	1,422.7	1,014.9	530.5	440.6	341.2	26.5	31.0	33.6	−21.1
Michigan	2,715.2	1,896.2	1,319.9	838.1	655.5	490.9	30.9	34.6	35.3	−12.5
Minnesota	1,256.4	868.6	597.9	409.3	311.4	237.6	32.6	35.9	39.7	−17.9
Mississippi	451.3	316.8	233.5	128.3	104.7	75.9	27.8	33.0	32.5	−14.5
Missouri	1,198.9	818.6	551.2	285.9	219.7	158.0	23.8	26.8	28.7	−17.1
Montana	212.8	162.1	125.4	76.4	60.7	48.6	35.9	37.4	38.8	− 7.5
Nebraska	389.6	270.7	200.1	77.1	58.2	46.5	19.8	21.5	23.2	−14.7
Nevada	166.2	95.2	59.9	57.3	32.0	22.1	34.5	33.6	36.9	− 6.5
New Hampshire	176.9	125.5	86.6	45.1	35.1	27.5	25.5	28.0	31.8	−19.8
New Jersey	2,239.8	1,507.9	987.1	643.8	561.4	402.7	28.7	37.2	40.8	−29.7
New Mexico	271.8	187.2	127.6	86.7	68.3	35.7	31.9	36.5	28.0	+13.9
New York	8,423.6	5,451.5	3,711.6	2,617.2	1,755.1	1,305.0	31.1	32.2	35.2	−11.6
North Carolina	1,129.3	738.8	501.5	316.5	217.3	162.8	28.0	29.4	32.5	−13.8
North Dakota	178.4	134.9	107.8	40.7	31.7	25.0	22.8	23.5	23.2	− 1.7
Ohio	2,612.1	1,986.2	1,398.2	872.1	687.4	439.2	33.4	34.7	31.4	+ 6.4
Oklahoma	629.0	458.1	344.7	200.3	141.9	117.5	31.8	31.0	34.0	− 6.5
Oregon	631.3	417.9	347.9	201.8	144.0	123.2	32.0	34.5	35.4	− 9.6
Pennsylvania	3,241.8	2,335.6	1,769.8	915.6	689.3	676.3	28.2	29.5	38.2	−26.2
Rhode Island	266.9	188.7	129.7	75.5	53.8	43.1	28.3	28.5	33.2	−14.8
South Carolina	510.8	330.6	244.8	147.3	89.2	69.6	28.8	27.0	28.4	+ 1.4
South Dakota	204.5	152.2	112.2	38.6	29.4	20.8	18.9	19.3	18.5	+ 2.2
Tennessee	820.7	528.3	402.8	210.4	143.8	106.8	25.6	27.2	26.5	− 3.4
Texas	2,471.2	1,850.8	1,253.3	982.5	836.7	652.6	39.8	45.2	52.1	−23.6
Utah	299.6	205.1	136.3	86.9	69.1	52.1	29.0	33.7	38.2	−24.1
Vermont	133.9	92.1	64.5	32.2	24.1	17.3	24.0	26.2	26.8	−10.4
Virginia	1,070.7	623.5	423.0	285.0	213.5	157.5	26.6	34.2	37.2	−28.5
Washington	1,108.6	759.6	511.8	313.9	225.0	156.4	28.3	29.6	30.6	− 7.5
West Virginia	400.4	306.4	218.9	145.1	110.6	90.8	36.2	36.1	41.5	−12.8
Wisconsin	1,517.6	974.6	706.6	407.6	291.1	250.5	26.9	29.9	35.5	−24.2
Wyoming	110.3	82.0	60.3	44.2	29.0	24.3	40.1	35.4	40.3	− 0.5

N/A Data not available.

[1] Excluding unemployment compensation.

Source: Estimates prepared by ACIR staff from data published by the Governments Division, U. S. Bureau of the Census, and U.S. Department of Agriculture.

TABLE B-2: Total State Taxes and State Taxes With an Initial Impact on Business, 1968, 1970, and 1971[1]

(Dollar Amounts in Thousands)

State	1971				1970				1968			
	Total State Taxes	State Taxes With an Initial Impact on Business	Business Taxes as % of Total	Rank	Total State Taxes	State Taxes With an Initial Impact on Business	Business Taxes as % of Total	Rank	Total State Taxes	State Taxes With an Initial Impact on Business	Business Taxes as % of Total	Rank
All States	$51,552,444	$ 8,061,897	15.6%		$47,904,776	$ 7,847,273	16.4%		$36,414,469	$ 6,029,246	16.6%	
Alabama	709,933	115,527	16.3	17	657,361	105,772	16.1	17	531,662	73,167	13.8	25
Alaska	102,054	31,274	30.6	3	85,899	25,028	29.1	4	60,402	14,976	24.8	6
Arizona	523,113	49,340	9.4	37	474,270	41,021	8.6	40	315,916	29,583	9.3	38
Arkansas	379,810	46,854	12.3	27	351,447	45,429	12.9	26	289,644	35,280	12.1	30
California	5,675,445	760,632	13.4	23	5,497,548	799,326	14.5	20	4,663,369	768,417	16.4	16
Colorado	513,742	53,536	10.4	33	470,060	53,300	11.3	31	361,251	43,570	12.0	31
CONNECTICUT	795,589	230,272	28.9	4	741,789	200,225	27.0	5	499,826	138,274	27.7	3
Delaware	222,180	82,937	37.3	2	195,648	69,946	35.8	2	144,789	40,999	28.3	2
Florida	1,587,183	126,891	8.0	43	1,421,109	106,680	7.5	44	973,130	84,096	8.7	40
Georgia	990,951	115,413	11.6	30	941,334	116,430	12.4	28	737,181	92,106	12.4	28
Hawaii	372,712	40,502	10.9	31	340,450	38,760	11.4	30	242,655	29,911	12.3	29
Idaho	187,379	25,648	13.7	21	155,880	22,231	14.3	23	136,788	17,586	12.9	26
Illinois	3,142,311	396,009	12.6	25	2,868,694	394,528	13.8	24	1,730,634	199,068	11.6	32
Indiana	1,054,296	46,480	4.4	49	1,002,418	40,749	4.1	49	819,152	40,139	5.0	48
Iowa	636,838	44,714	7.0	45	628,327	43,918	7.0	45	502,453	35,719	7.1	43
Kansas	463,141	46,648	10.1	35	430,975	39,332	9.1	37	357,045	36,156	10.1	35
Kentucky	760,335	74,065	9.7	36	703,044	66,573	9.5	36	509,316	76,122	15.0	19
Louisiana	988,715	388,879	39.3	1	838,792	360,575	43.0	1	740,436	337,068	45.6	1
Maine	228,823	21,551	9.4	38	207,617	20,711	10.0	35	146,145	11,684	8.0	42
Maryland	1,146,255	123,920	10.8	32	1,082,058	108,619	10.0	34	771,368	77,937	10.1	36
Massachusetts	1,494,291	280,490	18.8	13	1,393,653	289,187	20.8	9	1,033,363	223,387	21.7	9
Michigan	2,543,856	388,731	15.2	19	2,345,090	377,063	16.1	18	1,885,629	198,944	10.6	34
Minnesota	1,099,070	157,722	14.4	20	1,020,953	166,533	16.3	16	815,122	137,434	16.9	15
Mississippi	517,290	65,091	12.6	26	485,755	62,007	12.8	27	322,520	52,169	16.2	17
Missouri	826,662	74,688	9.0	39	820,860	72,604	8.8	39	656,967	60,317	9.2	39
Montana	135,840	25,582	18.8	12	128,823	24,427	19.0	14	104,973	17,804	17.0	14
Nebraska	294,447	23,359	7.9	44	261,307	21,677	8.3	42	193,977	12,750	6.6	44
Nevada	172,517	6,611	3.8	50	149,208	6,042	4.0	50	103,528	4,929	4.8	49

(Cont'd)

TABLE B-2: Total State Taxes and State Taxes With an Initial Impact on Business, 1968, 1970, and 1971[1]

(Dollar Amounts in Thousands)

State	1971				1970				1968			
	Total State Taxes	State Taxes With an Initial Impact on Business	Business Taxes as % of Total	Rank	Total State Taxes	State Taxes With an Initial Impact on Business	Business Taxes as % of Total	Rank	Total State Taxes	State Taxes With an Initial Impact on Business	Business Taxes as % of Total	Rank
New Hampshire	118,465	21,377	18.0	15	94,765	10,183	10.7	32	75,261	6,328	8.4	41
New Jersey	1,501,047	274,143	18.3	14	1,332,251	309,258	23.2	7	953,954	199,403	21.0	11
New Mexico	294,260	57,398	19.5	10	266,458	53,754	20.2	12	217,137	45,878	21.1	10
New York	6,291,315	963,376	15.3	18	6,116,519	1,001,128	16.4	15	4,447,165	640,582	14.4	23
North Carolina	1,296,974	259,746	20.0	9	1,190,210	243,891	20.5	11	930,150	202,488	22.4	8
North Dakota	142,242	17,531	12.3	28	121,646	12,350	10.2	33	101,456	12,816	12.7	27
Ohio	1,772,541	300,574	17.0	16	1,702,624	271,914	16.0	19	1,370,216	199,688	14.6	22
Oklahoma	540,918	110,663	20.5	8	502,121	107,873	21.5	8	427,502	96,939	22.7	7
Oregon	444,218	53,321	12.0	29	430,686	62,237	14.5	22	324,797	50,367	15.6	18
Pennsylvania	3,093,520	849,804	27.5	5	2,777,578	872,279	31.4	3	2,003,580	497,120	24.9	5
Rhode Island	272,085	61,840	22.7	7	228,674	47,048	20.6	10	166,652	33,967	20.3	12
South Carolina	600,478	77,964	13.0	24	543,678	74,474	13.7	25	412,398	61,438	14.9	20
South Dakota	121,730	6,758	5.6	47	112,725	5,976	5.3	47	87,873	5,524	6.2	45
Tennessee	739,920	140,834	19.0	11	686,936	134,909	19.6	13	577,320	116,044	20.1	13
Texas	2,188,041	559,601	25.6	6	1,924,788	494,852	25.7	6	1,437,971	396,494	27.6	4
Utah	268,892	23,452	8.7	41	251,596	22,820	9.1	38	183,510	17,917	9.8	37
Vermont	141,057	12,373	8.8	40	135,176	11,658	8.6	41	88,172	9,716	11.0	33
Virginia	1,040,555	140,090	13.5	22	955,726	138,819	14.5	21	731,674	107,904	14.8	21
Washington	1,126,357	71,817	6.4	46	1,028,028	64,232	6.2	46	878,644	54,769	6.2	46
West Virginia	436,235	21,136	4.8	48	384,993	18,235	4.7	48	320,576	15,907	5.0	47
Wisconsin	1,423,085	146,527	10.3	34	1,332,754	164,128	12.3	29	990,548	137,920	14.0	24
Wyoming	93,241	7,716	8.3	42	84,475	6,562	7.8	43	68,671	2,613	3.9	50

[1] Excluding unemployment compensation taxes.

Sources: U.S. Bureau of the Census, *State Government Finances* and *State Tax Collections;* Connecticut Public Expenditure Council.

ences: Alaska and Louisiana have the extractive industry, and Delaware has corporations simply taking advantage of its corporation franchise and incorporation law.

The relative decline in the importance of business taxes can be attributed mainly to the concerted effort by legislators and policy-makers generally to create a favorable tax image for economic and industrial development. Whether or not these attempts to maximize the attractiveness to business of the State's tax image have "paid off" is a question of some debate.[5] But, few would deny that unfavorable tax comparisons and/or taxes that are widely disliked because of their arbitrariness and unfairness may present obstacles to economic expansion.

The rationale behind the issues of interstate competition for business location has been summarized as follows:

> "This awareness of economic competitive effects has become much more acute in recent years. This is to be expected, for at least two reasons. First, the level of State and local taxes, relative to the size of the nation's economy, has increased sharply; tax differentials which were inconsequential when the levels of taxation were low can be of real consequence now. Second, the various parts of the country have become more alike economically and thus firms have a wider range of choice in their locational decisions. In some cases, especially within metropolitan areas, tax differentials can be among the only significant differences. Moreover, a government concerned for economic development finds that tax policy is just about the *only* locational factor which local decision-makers can effect."[6]

Trends In The Connecticut Economy

The data presented in Tables B-3 to B-6 are designed to offer some insights, in terms of employment, on major trends in the Connecticut economy since 1950. One of the most significant points to be noted is the fact that employment in Connecticut manufacturing (primarily in dura-

TABLE B-3: Employment in Connecticut, 1971

Industry	Employment* (000)	Composition Percent	Percent Change From Prior Year
All Private Non-agricultural Industries	1,004.8	100.0	- 3.69
Contract Construction and Mining	55.3	5.5	- 3.32
Manufacturing	400.9	39.9	-10.05
Ordnance and Accessories	8.9	0.9	-11.88
Primary Metal Industries	22.6	2.2	-11.37
Fabricated Metal Products	54.2	5.4	- 8.76
Machinery (Except Electrical)	52.7	5.2	-14.45
Electrical Equipment and Supplies	40.6	4.0	-10.57
Transportation Equipment	76.3	7.6	-13.00
Instruments and Related Products	18.2	1.8	-14.15
Food and Kindred Products	13.2	1.3	- 8.33
Textile Mill Products	12.8	1.3	- 1.54
Apparel and Other Textile Products	13.4	1.3	0.75
Lumber and Furniture	6.3	0.6	- 5.97
Paper and Allied Products	8.0	0.8	-12.09
Printing and Publishing	19.3	1.9	- 1.03
Chemicals and Allied Products	14.5	1.4	- 5.85
Rubber and Plastic Products	15.5	1.5	- 7.19
Transportation	26.5	2.6	- 2.57
Communications and Utilities	26.6	2.6	- 2.57
Wholesale Trade	49.4	4.9	- 0.80
Retail Trade	176.5	17.6	- 0.56
Finance, Insurance and Real Estate	76.6	7.6	3.51
Insurance	44.2	4.4	4.25
Insurance Carriers	39.0	3.9	5.98
Services	193.1	19.2	4.66

*Excludes government employment.

Source: Connecticut Department of Labor, Employment Security Division.

TABLE B-4: Percentage Distribution of Private Non-Agricultural Employment in Connecticut and the U. S. by Industry, 1950-71

Industry	Connecticut							U.S.						
	1950	1960	1965	1968	1969	1970	1971	1950	1960	1965	1968	1969	1970	1971
All Private Non-agricultural Industries	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Contract Construction and Mining	5.4	5.4	5.4	5.2	5.3	5.5	5.5	8.3	7.8	7.5	6.9	7.0	6.8	6.7
Manufacturing	54.3	49.6	47.6	46.6	45.3	42.7	39.9	38.9	36.6	35.6	35.3	34.7	33.3	32.2
Ordnance & Accessories	1.3	1.0	0.9	1.4	1.3	1.0	0.9	0.1	0.5	0.4	0.6	0.5	0.4	0.3
Primary Metal Industries	4.8	3.5	2.9	2.6	2.5	2.4	2.2	3.2	2.7	2.6	2.3	2.3	2.3	2.1
Fabricated Metal Products	7.8	5.8	5.7	5.6	5.8	5.7	5.4	2.5	2.5	2.5	2.5	2.5	2.4	2.3
Machinery (Except Electrical)	8.2	7.6	7.0	6.6	6.3	5.9	5.2	3.1	3.2	3.4	3.5	3.5	3.4	3.1
Electrical Equipment & Supplies	5.4	4.7	4.7	4.9	4.7	4.4	4.0	2.5	3.2	3.3	3.5	3.5	3.3	3.1
Transportation Equipment	3.4	8.9	9.7	10.2	9.3	8.4	7.6	3.2	3.4	3.4	3.6	3.6	3.1	3.0
Instruments & Related Products	1.9	2.1	2.0	2.1	2.2	2.0	1.8	0.6	0.8	0.8	0.8	0.8	0.8	0.7
Jewelry, Silverware & Plated Ware	1.1	0.5	0.5	0.4	0.4	0.4	N/A	0.1	0.1	0.1	0.1	0.1	0.1	N/A
Food & Kindred Products	1.8	1.6	1.5	1.4	1.4	1.4	1.3	4.6	3.9	3.5	3.2	3.1	3.1	3.0
Textile Mill Products	4.8	1.9	1.6	1.4	1.4	1.2	1.3	3.2	2.0	1.8	1.8	1.7	1.7	1.7
Apparel & Other Textile Products	3.9	2.3	1.8	1.5	1.4	1.3	1.3	3.1	2.7	2.7	2.5	2.4	2.4	2.4
Lumber & Furniture	0.6	0.7	0.7	0.7	0.7	0.6	0.6	3.0	2.2	2.0	1.9	1.9	1.8	1.8
Paper & Allied Products	1.0	1.0	0.9	0.9	0.9	0.9	0.8	1.2	1.3	1.3	1.2	1.2	1.2	1.2
Printing & Publishing	1.7	1.9	1.8	1.9	1.9	1.9	1.9	1.9	2.0	1.9	1.9	1.9	1.9	1.9
Chemicals & Allied Products	1.2	1.6	1.4	1.4	1.4	1.5	1.4	1.6	1.8	1.8	1.8	1.8	1.8	1.8
Rubber & Plastic Products	2.2	2.0	1.9	1.6	1.6	1.6	1.5	0.8	0.8	0.9	1.0	1.0	1.0	1.0
Transportation	3.5	2.8	2.7	2.6	2.6	2.6	2.6	7.1	5.6	5.0	4.8	4.7	4.6	7.7
Communications & Utilities	2.5	2.6	2.4	2.4	2.4	2.6	2.6	3.3	3.2	3.0	2.9	3.0	3.1	
Wholesale Trade	3.8	4.1	4.2	4.4	4.5	4.8	4.9	6.4	6.5	6.5	6.4	6.4	6.6	6.7
Retail Trade	14.2	15.3	16.0	16.0	16.4	17.0	17.6	17.5	18.3	18.5	18.7	18.8	19.1	19.6
Finance, Insurance & Real Estate	5.3	6.5	6.4	6.6	6.6	7.1	7.6	4.9	5.8	6.0	6.0	6.1	6.4	6.6
Insurance	3.4	3.9	3.8	3.8	3.8	4.1	4.4	1.9	2.2	2.2	2.2	2.2	2.3	N/A
Insurance Carriers	3.0	3.4	3.3	3.4	3.3	3.5	3.9	1.5	1.8	1.8	1.8	1.7	1.8	N/A
Conn. Insurance Companies	2.2	2.7	2.6	2.6	2.7	2.9	3.1							
Services	11.0	13.7	15.3	16.3	16.9	17.7	19.2	13.7	16.2	17.9	18.9	19.3	20.0	20.6

Source: U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Office of Business Economics; Connecticut Department of Labor, Employment Security Division; Connecticut Insurance Companies.

TABLE B-5: Index of Connecticut Industrial Specialization, 1950-71

Industry	1950	1960	1965	1969	1970	1971
Contract Construction and Mining	0.65	0.69	0.72	0.77	0.80	0.82
Manufacturing	1.40	1.35	1.34	1.30	1.28	1.24
Ordnance and Accessories	16.72	2.03	2.08	2.34	2.33	2.65
Primary Metal Industries	1.50	1.30	1.14	1.08	1.08	1.06
Fabricated Metal Products	3.11	2.36	2.27	2.32	2.40	2.34
Machinery (Except Electrical)	2.67	2.36	2.05	1.80	1.73	1.69
Electrical Equipment and Supplies	2.15	1.47	1.44	1.34	1.31	1.31
Transportation Equipment	1.06	2.61	2.84	2.62	2.70	2.51
Instruments and Related Products	3.05	2.71	2.56	2.69	2.58	2.42
Jewelry, Silverware, and Plated Ware	7.82	5.51	5.09	4.63	4.18	N/A
Food and Kindred Products	0.38	0.42	0.44	0.44	0.45	0.43
Textile Mill Products	1.50	0.93	0.87	0.79	0.74	0.77
Apparel and Other Textile Products	1.28	0.84	0.69	0.58	0.54	0.57
Lumber and Furniture	0.21	0.32	0.35	0.36	0.36	0.35
Paper and Allied Products	0.81	0.74	0.72	0.73	0.72	0.67
Printing and Publishing	0.87	0.96	0.94	0.99	0.98	1.02
Chemicals and Allied Products	0.74	0.91	0.80	0.76	0.82	0.82
Rubber and Plastic Products	2.79	2.43	2.01	1.60	1.60	1.53
Transportation	0.49	0.51	0.54	0.55	0.56	N/A
Communications and Utilities	0.77	0.82	0.81	0.82	0.84	N/A
Wholesale Trade	0.59	0.63	0.64	0.70	0.73	0.74
Retail Trade	0.81	0.84	0.86	0.87	0.89	0.90
Finance, Insurance, and Real Estate	1.08	1.11	1.08	1.08	1.12	1.16
Insurance	1.79	1.73	1.70	1.74	1.79	N/A
Insurance Carriers	1.98	1.88	1.88	1.92	1.96	N/A
Services	0.80	0.85	0.85	0.87	0.88	0.93

Source: See Table B-4.

TABLE B-6: Private Non-Agricultural Employment in Connecticut as a Percent of Private Non-Agricultural Employment in the U. S. by Industry, 1950-71

Industry	1950	1960	1965	1968	1969	1970	1971
All Private Non-agricultural Industries	1.79	1.79	1.81	1.82	1.80	1.80	1.74
Contract Construction and Mining	1.17	1.24	1.30	1.35	1.38	1.44	1.43
Manufacturing	2.49	2.42	2.41	2.40	2.34	2.30	2.15
Ordnance and Accessories	29.67	3.64	3.76	4.14	4.20	4.17	4.61
Primary Metal Industries	2.67	2.32	2.07	1.98	1.94	1.94	1.85
Fabricated Metal Products	5.55	4.23	4.11	4.08	4.17	4.30	4.07
Machinery (Except Electrical)	4.77	4.22	3.71	3.43	3.23	3.12	2.94
Electrical Equipment & Supplies	3.84	2.62	2.60	2.51	2.41	2.36	2.27
Transportation Equipment	1.90	4.68	5.14	5.08	4.71	4.85	4.36
Instruments & Related Products	5.44	4.85	4.63	4.63	4.83	4.62	4.21
Jewelry, Silverware, & Plated Ware	13.94	9.86	9.19	8.05	8.27	7.50	N/A
Food & Kindred Products	0.69	0.75	0.79	0.80	0.80	0.81	0.75
Textile Mill Products	2.68	1.67	1.58	1.40	1.41	1.33	1.33
Apparel & Other Textile Products	2.29	1.50	1.24	1.07	1.03	0.97	0.98
Lumber & Furniture	0.38	0.56	0.64	0.63	0.64	0.65	0.61
Paper & Allied Products	1.44	1.33	1.30	1.33	1.32	1.29	1.16
Printing & Publishing	1.55	1.71	1.69	1.77	1.77	1.76	1.77
Chemicals & Allied Products	1.33	1.63	1.45	1.35	1.37	1.46	1.43
Rubber & Plastic Products	4.98	4.35	3.63	2.96	2.88	2.88	2.66
Transportation	0.88	0.91	0.97	0.98	0.98	1.01	N/A
Communications and Utilities	1.38	1.47	1.47	1.50	1.48	1.50	N/A
Wholesale Trade	1.06	1.14	1.17	1.24	1.26	1.30	1.28
Retail Trade	1.45	1.50	1.56	1.56	1.57	1.60	1.56
Finance, Insurance, & Real Estate	1.92	1.99	1.96	1.98	1.94	2.01	2.02
Insurance	3.20	3.10	3.07	3.16	3.12	3.21	N/A
Insurance Carriers	3.53	3.37	3.39	3.49	3.45	3.52	N/A
Services	1.43	1.51	1.55	1.56	1.57	1.59	1.62

Source: See Table B-4.

ble goods manufacturing) has declined steadily over the last decade in terms of both absolute numbers and in terms of its share of the national total. This reduction has been cushioned somewhat by more than a doubling in the service-oriented industries, particularly insurance.

The highlights of these employment trends can be summarized as follows:

1. Private, non-agricultural employment in Connecticut declined almost 4% between 1970 and 1971. Manufacturing in total recorded a 10% reduction in jobs. Every type of manufacturing (except apparel and textiles) contributed to the job losses. The percentage reductions ranged from about 1% in printing and publishing to over 14% in the manufacture of machinery and instruments.

   The largest single percentage *increase* in Connecticut private sector employment opportunities in 1971 over the prior year was recorded by insurance companies — 6% (Table B-3).

   Only two private industrial sectors showed increases in employment in 1971, and both were in the service-related areas—finance, insurance, and real estate and services (business, professional, etc.) generally (Table B-3).

2. The most recent Connecticut employment data continue the trends begun as far back as 1950; namely, a gradual but consistent reduction in the reliance on manufacturing in the employment structure of the State and nation. In 1950, Connecticut manufacturing accounted for 54% of all private-sector employment; in 1971 less than 40% of Connecticut's labor force was in manufacturing (Table B-4). Over the same period, Connecticut insurance companies increased their relative share of total job opportunities by 41% — a rate substantially higher than that for the U.S. as a whole (Table B-4).

3. As a measure of State industrial emphasis, the index of Industrial Specialization is computed as the ratio of percent of State employment to percent of national employment. Again, manufacturing is being replaced by financial services and particularly insurance as the major determinant of the structure of the State's economy. It has a larger than *pro-rata* share of the industry as a whole (Table B-5). Only manufacturing and financial services are sectors of State industrial specialization. All other industries are basically local market-oriented (Table B-5).

Commission Program

General

The Commission recognizes that the Connecticut economy is not realizing its full potential. And while there is no necessary causal relationship between tax levels and economic growth, and no statistical association between the two has been established, few would deny that unfavorable tax comparisons present a hindrance to economic expansion. Just how much may be gained in the effort to arrest or reverse recent employment trends in the Connecticut economy through reduction and structural reform in Connecticut's business taxes is uncertain; that an improvement must come of such measures, however, is clear.

The recommendations are intended to place Connecticut businesses on a competitive basis with other states with like geographic and/or economic environments. It is not the Commission's intent to recommend changes that will result in Connecticut businesses being taxed "lower" than those in competitive states. *The objective is to present business with an equitable and stable tax structure, which does not penalize investment within the State.*

It should be noted that while the Commission has recommended an overall reduction of business taxes in Connecticut, it has also recognized that in specific areas Connecticut business should bear an additional share of the State's revenue burden and can do so without mitigating our stated objectives.

The ultimate success of the program will be

measured by its ability to provide in Connecticut the opportunities for full employment, as well as generating additional revenue to the State and local governments by an expanded industrial base.

Investment Taxes

The major factors which cause Connecticut business tax structure to be uncompetitive with its neighbors deal mainly with what could be called investment taxes. Specifically these include:

1. *Personal Property Taxes on Machinery and Equipment*
2. *Personal Property Tax on Inventories*
3. *Sales Tax on Machinery and Equipment*

The area of greatest concern here is the personal property tax, which is higher in Connecticut than in any other comparable State. For example, there is no tax on business personalty in New York and Pennsylvania and relatively minor amounts collected in the other New England states. At its present level and annual rate of increase in Connecticut, it constitutes a major obstacle and potential deterrent to capital investment. Despite its value to local units of government as a revenue producer, the property tax on machinery and equipment is opposed on grounds of equity. In addition to the fact that equitable and uniform assessments are unattainable, the impact of the tax bears no relation to the volume or profitability of business. In pursuit of its objective to distribute more of the burden of business taxes from costs to profits and from taxes that impede progress and expansion particularly of industrial activity, **the Commission recommends immediate repeal of the local property tax on new purchases of machinery and equipment, furniture and fixtures, and all other personal property except motor vehicles, rolling stock of contractors, airplanes, and the personal property of public service companies.**

The revenue loss experienced by the local units of government from repeal of the local tax on machinery, equipment, and other business personal property will be an estimated $7 million the first year with a $7 million annual increase during the 10 years of implementation. The Commission recognizes the difficulties associated with the revenue loss to local units, but it believes the positive effects of the whole Commission reform package, including recommending increased assistance to these units, will more than compensate for the loss.[7]

The tax on inventories is currently in the process of being phased out (by 1976 for manufacturers and by 1982 for retailers and wholesalers). **The Commission recommends the continuance of this phase-out program.**

Connecticut also presently imposes a 7% "penalty" excise on the purchase and use of manufacturing and farming machinery and equipment in the State in the form of the retail sales tax. The Commission can find no justification either in the underlying rationale of the sales tax or in the revenue gained from extending the sales tax to the purchase by business of machinery and equipment to warrant continuation of the present practice. It too represents an additional "fixed" investment cost that must be borne by industry even before productive operations begin.

Since this tax has a particularly inhibiting effect on capital investment decisions within the State and represents a deterrent to business growth and increased employment, the Commission recommends its repeal. **To reduce the initial revenue loss impact it is recommended that this repeal be effected in two stages; 50% reduction effective July 1, 1973, and the balance effectively eliminated by July 1, 1976.**

Corporate Business Tax on Income

Connecticut's corporate net income tax rates among the highest among the states. **The Commission does not consider it necessary, however, to reduce the tax rate to remain competitive with other states,** in view of the balance established by its other recommendations.

It is recommended that business be permitted to carry forward operating and capital losses against future profits. The carryforward periods would conform to the Federal law. While Federal law also permits the carryback of certain losses, **the Commission feels that the "predictability" requirement for State revenues mitigates against adoption of the carrybacks for State purposes. The Commission recommends that consolidated corporate income tax returns should be permitted by Connecticut if they are filed for Federal tax purposes,** and if they follow the Federal consolidated return rules. In today's expanding multiple corporation environment, the necessity of preparing and filing multiple income tax returns for dif-

ferent companies operating in fact as a single economic entity has become a substantial administrative burden.

In addition to placing Connecticut corporations on a more equally competitive basis, the adoption of these recommendations should specifically encourage *new* location decisions — new businesses often operate at a loss in initial periods and are understandably discouraged by the prospect of paying taxes on profits of one year but receiving no recognition of losses of another year. It is necessary to provide for this averaging of earnings in cyclical situations.

Deduction For Interest Paid

Connecticut corporations are also burdened by a provision unique in state income tax laws — the disallowance as a business expense of a deduction of part of the interest paid. The Legislature has recognized the discriminatory nature of the provision by providing for its elimination as to corporations other than banks in 1974 and financial institutions in 1976 through graduated stages.

While acknowledging the present and continuing unfairness of this rule in denying a deduction for a specific and necessary business expense, **the Commission is not recommending a change in the scheduled phase-out periods due to their short durations. The Commission recommends, however, that this phase-out period not be lengthened.**

Minimum Alternative Tax

Connecticut's minimum alternative 4 mill capital tax applies where the amount calculated exceeds the normal corporate net income tax liability. The minimum alternative base for computation purposes includes both net worth (capital) of a corporation and its debt. Thus, the tax adversely affects those corporations which, if they are to expand their operations, must borrow outside capital, and/or those corporations in a loss position (often in the initial years of operations). No other state has such a burdensome tax. **For these reasons the Commission is recommending that the minimum alternative tax be repealed.**

The Commission believes, however, that all corporations doing business within the State should pay a minimum tax for the privilege of doing business and for the use of State services. **It, therefore, recommends the adoption of an alternative franchise tax along the lines of the Delaware statute, based on issued and outstanding shares.** The tax would apply only if the liability exceeded the corporate net income tax. The rate schedule would be substantially lower than the present alternative tax on capital and debt and would thus minimize its inequitable and discriminatory features. The range of the tax would vary from a minimum of $45 to approximately $100,000 for the largest corporations operating in the State.

The Commission recommendation does not apply to the minimum alternative tax calculation of two specialized industries. First, investment funds which are given special status under the U.S. Internal Revenue Code are provided limitations under present Connecticut law which should not be disturbed. Other states, recognizing the unique status of these investment funds, also provide special limitations. Secondly, banks and other financial corporations (as defined in Sec. 12-219, General Statutes), are liable for an alternative revenue based on interest and dividends paid or credited.

We have been furnished information that this alternative tax may create substantial adverse financial effects on many savings institutions within the immediate future. As discussed subsequently under "Areas for Additional Study" **the Commission recommends immediate review of special industries as to possible tax inequities** — financial corporations are specifically mentioned in this regard. This problem, in particular, would appear urgent enough for the Legislature to address at the next session. Possible approaches to the minimum alternative tax include a reduction from the present rate or a calculation of the tax based on net worth of financial institutions.

Insurance Companies — Phase-Out of Interest and Dividends Tax

Domestic insurance companies have been subject to two taxes which discriminate against domestic insurance companies: a 3½% tax on interest and dividends which is scheduled to be reduced to 2⅜% on July 1, 1973 and to expire on December 31, 1973, and a tax on insurance premiums of ½ to ¾% higher than the 2% paid by out-of-state insurance carriers on Connecticut business; the premium tax is due to be equalized on all net limit premiums at the 2% rate on July

1, 1973. The Commission has noted the tendency of some Connecticut insurance companies to locate facilities and home office operations in other states and to form subsidiaries domiciled in other states. In order to encourage Connecticut insurance companies to expand in Connecticut and to provide jobs for Connecticut citizens, **the Commission favors the existing legislation which provides that the interest and dividend tax shall expire after December 31, 1973 and the premium tax for domestic and foreign insurance companies will be equalized at 2% on July 1, 1973.**

Insurance Industry Under Corporate Income Tax

There is presently no provision for income taxation of insurance companies after the elimination of the interest and dividend tax in 1973.

It is recommended that insurance companies be made subject to the corporation net income tax provisions of the Connecticut corporation business tax and, for the reasons set forth above, taxes which discriminate against domestic insurance companies be avoided in the future.

Summary of Business Tax Reforms

The Commission's specific tax recommendations in the initial years of enactment would result in the following increases and decreases in tax burdens on business (on an annual basis) as compared with its tax burdens under the taxes currently (1972) in effect:

Recommended Tax Change	Annual Increase (+) or Decrease (−) In Tax Liability (in millions)
Change at local level	
Personal Property Tax	
Initial reduction of tax on new manufacturing and farming machinery and equipment	—$ 7.0
Change at State level	
Corporation Business Tax	
Full use of Federal loss carryforward and use of Federal consolidated returns	— 3.0
Repeal minimum alternative capital tax	— 10.0
Adopt minimum alternative franchise tax	+ 5.0
Impose net income tax on insurance companies	+ 7.0
Sale and Use Tax	
Initial reduction of tax on purchases of machinery and equipment to 50% (assuming 7% rate)	— 20.0
Total Net Change at State Level	—$21.0

Areas For Additional Study

The Commission's business tax reform program does not purport to have treated the subject of Connecticut State-local business taxation exhaustively; however, it is believed the program will succeed in pursuing a reasonable pattern for revision in line with the Commission's guiding principles. The application of these principles to areas not specifically dealt with directly should be clear. Any further revision must be tested against the following standards:

1. Do they develop the incentives and conditions for the expansion of economic activity in the State, and do they maintain a competitive position with respect to other States, to retain and attract economically desirable enterprises that have freedom of choice as to where they will locate?
2. Do they fairly allocate the tax responsibility between business and individuals?
3. Do they meet the test of efficient administration and effective enforcement?

The Commission has compiled information and has heard testimony as to Connecticut's taxation of many special industries. However, it has decided not to recommend special consideration for these industries at this time. One of the reasons is that the general business tax relief recommended in the report will be of assistance to all Connecticut industries. The Commission recognizes that discriminatory tax provisions affect certain industries and may have an adverse effect on the economic well being of the State. But, taxes imposed on special industries often reflect non-revenue objectives which must be considered apart from the tax aspects. The Commission hopes that thorough studies can be made in the near future and appropriate action taken, where it is equitable from the standpoint of the State's business tax goals.

Three industries for which intensive studies would appear necessary and appropriate are banks, utilities, and transportation:

Financial Corporations—A study of the relative tax burden of this Connecticut industry is particularly difficult because of (1) the different ways in which the various states tax banks, and (2) the differential effects of Connecticut's rules on commercial banks, mutual savings banks and savings and loan associations. In addition, the historical and competitive differences of these three major segments of the financial industry appear to be in a period of substantial changes which should probably have a significant impact on the design of any new tax program. As previously noted, the "interest add-back" feature of Connecticut's corporate income tax law is phasing out, with obvious favorable implications for banking institutions.

Public Utilities — Connecticut utilities are currently subject to the corporate income tax and a gross earnings tax; in addition, the consumer in some instances pays the regular 7% sales tax on utilities services. The gross receipts tax, while paid by the utility, is in effect passed on to the consumer, and when added to the retail sales tax, often results in a "sales" tax of 12% or 13%. While many other states tax utilities in the same manner (i.e., corporate income tax, gross receipts tax and sales tax) the 12% or 13% levels appear to be high when compared to other states.

Transportation — Certain segments of the transportation industry (which includes air, bus, train, truck, water transport, etc.) have varied and serious problems, of which tax burdens are only one element. The day-to-day crisis involving commuter services of railways and bus companies is only one example. Again, any tax study must incorporate many non-tax issues as to each segment of industry. It should be noted, however, that an adequate transportation system and competitive freight rates do play an important part in the economic well-being of Connecticut.

Unincorporated Business — The Commission recognizes that an inequality of tax treatment currently exists between incorporated and unincorporated businesses (or their owners) in Connecticut. Since corporations are subject to the Connecticut business tax, unincorporated firms free from a comparable cost gain a competitive advantage. Although the primary issue in reviewing the question of an unincorporated business tax for Connecticut is equality or impartiality of tax treatment, administrative and compliance considerations are particularly significant. Only three major sub-national government units impose a net income tax on unincorporated businesses (the State and City of New York and the District of Columbia) and these with varying degrees of success. In all three cases, either selected or all professions are excluded from the tax. Moreover, in practice, because of the vagueness of the term "profession," virtually all personal service enterprises are not on the tax rolls. Finally, to accommodate small businesses, a specific dollar exemption is normally granted. In sum, experience elsewhere with unincorporated business taxes does not provide much insight for a serious consideration of this important issue. Though intended to remove one inequality, the tax has frequently generated other discriminatory effects,

with little offset in the way of revenues. These and related problems need to be carefully explored before recommendations can be made. As in other areas, simultaneous achievement of the major objectives of business tax policy are often in conflict, in the sense that movement in the direction of one means that another will be achieved less adequately, if at all. The appropriate assignment of priorities to each of these objectives comes only after intensive review and evaluation.

APPENDIX

Dissent of Robert O. Harvey

The Commission recommends for non-financial corporations the replacement of the minimum alternative four mill tax on capital with a minimum alternative franchise tax measured by authorized corporate shares. The Commission has not proposed an alternative plan for commercial banks, savings banks, and savings and loan associations. The Commission has, however, urged the legislature to revise the present minimum alternative tax for financial institutions and to do so as quickly as possible.

Financial institutions have not yet been called upon to pay the minimum alternative tax. However, impending national regulatory changes will alter the competitive positions among commercial banks, savings banks, and savings and loan associations so that the savings institutions will have a higher probability of paying the minimum alternative tax. The present minimum alternative tax is less serious for commercial banks than for savings banks and savings and loan associations because of the vastly greater profitability of commercial banks.

If financial institutions were in a position to have to pay the present alternative tax, they (especially savings banks and savings and loan associations) would be subjected to substantial reductions in net worth. It is estimated that a savings and loan association with no net income subject to the state corporate income tax would, under the present formula, pay a tax amounting to 25%-33⅓% of its surplus and undivided profits, the only unencumbered accounts to which the tax could be charged. The tax, if operative, would result in serious impairment of the financial institutions affected and conceivably result in their demise.

The matter is of such seriousness and urgency that I dissent from the Commission's not advocating a specific alternative to the present tax.

FOOTNOTES TO PART B

1 As defined in Sec. 16-1, Connecticut General Statutes.

2 Computed from data provided by Connecticut Department of Labor and Tax Department.

3 James W. Wightman, *The Impact of State and Local Fiscal Policies on Redevelopment Areas in the Northeast*, Federal Reserve Bank of Boston, Research Report No. 40 (March, 1968), Chapter V and Appendix B.

4 ACIR, *State-Local Finances: Significant Features and Suggested Legislation* (Washington: U.S. Government Printing Office, 1972).

5 John F. Due, "Studies of State-Local Tax Influences on Location of Industry," *National Tax Journal* (June, 1961).

6 Dick Netzer, "Federal Grants and State Revenues," National Municipal League, National Conference on Government (Boston, November, 1965).

7 See Volume I, Part D, for summary of the fiscal effect of the Commission's program.

PART C

Procedural Reform

Introduction

Until now, there has never been an attempt made to examine all Connecticut's substantive and procedural tax provisions. Other parts of this Report recommend major policy changes in the substantive tax laws of Connecticut.[1] The study upon which this part of the Report is based, besides covering tax procedure and administration, also examined the organization of Connecticut's tax laws.

The administrative and procedural tax statutes are confusing, contradictory, and instead of being improved by the newly enacted Administrative Procedure Act, were made worse by it. Taxpayers' rights of appeal, both within the Tax Department and in the courts, are confusing and difficult to follow. The ability of the State Tax Commissioner to collect taxes to which Connecticut is legally entitled is seriously impaired by unsatisfactory lien powers.

Connecticut's tax system could be made to function more efficiently and fairly. It should be redesigned so that more of the taxes to which the State is legally entitled could be collected at a lower cost. In addition, clear procedures should be established for taxpayers to have prompt and inexpensive opportunities to be heard when they disagree with the application of the tax law to their particular situation.

The necessary reforms to accomplish these improvements include collecting all tax statutes into Title 12 and reorganizing them into a Connecticut Revenue Code, eliminating conflicting provisions, providing for clear, informal and simple appellate procedures, appointing a Chief Counsel in the Tax Department to handle all of its legal work, and creating a Tax Policy and Advisory Group to be available on a continuing basis to make recommendations to the Legislature for future changes in the State's tax structure.

Findings

1. **Deficient Tax Procedure—Uniform Administrative Procedure Act.**

The Commission finds that the administration and collection of most Connecticut taxes is hampered by poorly organized and drafted statutes, combined with outmoded and conflicting procedure. As each tax was enacted, it was accompanied by a new and often unique set of procedural rules. They dealt with assessment, administrative and judicial appeals, enforcement, liens, and penalties. The provisions, especially those dealing with taxpayers' rights of appeal, are sometimes incomplete and confusing. Courts have, however, required strict compliance with their terms. This leads to potential inequities in taxpayer appeals.

If papers filed in an appeal from a decision of the Tax Commissioner do not conform with the statutes, and are therefore declared improper by the court, the taxpayer's time to appeal may have expired. The courts have held in such cases that he has no further right of appeal. There have been unfortunate instances were technical defects in an appeal, often caused by vague statutory provisions, deprived a taxpayer of the opportunity for a hearing of his appeal on its merits.

The Commission finds that these conflicts and inconsistencies were not adequately resolved by the newly adopted Uniform Administrative Procedure Act.[2] This Act was designed to provide a single procedure for appeal from any administrative decision, but it has created even more confusion. The Act does not clearly indicate whether existing procedural provisions were repealed. Its passage was followed by reenactment of specific State tax statutes. These included certain procedural provisions inconsistent with the Administrative Procedure Act.

2. **Inadequate Lien Rights.**

The Commission finds that the State Tax Commissioner is hampered in collecting delinquent State taxes, because of inadequate lien rights. The State of Connecticut has no lien rights for the collection of cigarette, gasoline, special fuel, motor carrier road, admissions, and club dues taxes. Where lien rights do exist, in most in-

stances they attach only to real estate and in practice are not an effective means of collecting delinquent taxes.

This antiquated system of lien rights places Connecticut far behind other states in protecting its vested interest in collecting overdue or delinquent taxes. See Appendix A for a Summary of Liens for State Taxes in Connecticut.

3. **Death taxes.**

The Commission finds that the only exceptions to deficient administrative procedural provisions are the succession and estate taxes. Major changes in their procedure were recently enacted.[3] Accelerated filing and payment provisions affect estates of persons dying after July 1, 1971, while the procedural reforms are applicable to the collection of these taxes from estates of persons dying after December 31, 1971.

The changes have not been in force long enough to determine how effective they will be. But the revisions were carefully considered by the State Tax Commissioner, the Probate Assembly, members of the Bar, and the banks. They are expected to make death tax collection and administration more efficient, overcoming problems that previously existed. Nevertheless, there is still some uncertainty as to applicable procedure, since the Administrative Procedure Act appears to apply to all State tax proceedings, and its provisions are inconsistent with the newly adopted succession tax procedure.

The Commission finds that because of their close association with the probate process, death taxes continue to require different collection provisions than the 25 other State taxes.[4]

Recommendations

The Commission recommends that:

1. All tax laws be reorganized into a Connecticut Revenue Code.

Title 12 of the General Statutes, dealing with Taxation and other Revenue Sources, should be completely revised and compiled into a comprehensive Connecticut Revenue Code, containing a logical and orderly arrangement of all substantive and procedural tax statutes, wherever they now appear.

2. Conflicts in the tax statutes, including conflicting provisions as to court jurisdiction, be eliminated and that the State Tax Commissioner be exempted from the Administrative Procedure Act.

Conflicts between the present tax procedure, the new Uniform Administrative Procedure Act, and other laws should be eliminated. While a number of the Administrative Procedure Act's concepts can be used in the Connecticut Revenue Code, the provisions of the Act are too general to deal effectively with taxation.

3. Tax procedure and administration for all taxes administered by the State Tax Commissioner, except death taxes, should be as uniform as practicable and that a procedure for issuing rulings to taxpayers be set up in the Tax Department.

A part of the recommended Connecticut Revenue Code should consist of internally consistent procedure and administration sections, with adequate lien provisions and a clear, informal, and simple method of taking administrative appeals in the tax department.

4. A study be made of the possible need for a State Tax Court.

5. Appeals in tax and condemnation valuation disputes be referred to referees, without short calendar hearings in the courts, and that the requirement that tax litigation be begun by a sheriff serving process be eliminated.

6. A Chief Counsel to the State Tax Commissioner be appointed by the Commissioner.

The Chief Counsel and his staff of attorneys (consisting initially of the one or two attorneys in the Attorney General's office who do tax work, an attorney in the Tax Department and its research section in an expanded form) would take over all tax work done by the Attorney General. They would: conduct all tax litigation (except death and property tax appeals), review all tax regulations before they are issued, advise the State Tax Commissioner or his delegate as to the hazards and costs of litigating a given issue, issue written opinions to the State Tax Commissioner upon his written request, and review rulings to be issued to taxpayers by the State Tax Commissioner.

7. Penalties for failure to file, filing a return late, or paying a tax late, should be uniform.

There should be no penalties for a deficiency except for one resulting from the filing of a false, fraudulent, or negligently prepared return or for failure to file a timely return. The Commissioner should have discretion to waive all or any portion of a penalty, according to standards prescribed by regulations. The desirability of changing criminal tax sanctions should be studied.

8. Interest should be at the same rate on both deficiencies and refunds.

The Commissioner should be required to recommend to the Legislature, before each annual session, whether or not this rate should be adjusted upward or downward.

9. Auditing procedures of the State Tax Commissioner should be made more efficient and productive and he should be permitted to retain a computer in his department.

A sales tax audit selection system, similar to that used by California, should be established. The staff of the Computation Section, under the First Assistant State Tax Commissioner for Inheritance Taxes, should be expanded so as to eliminate the costly delays (running to 4 or more months at present) in obtaining final computations of inheritance taxes.

A revolving audit fund should be created to receive all additional assessments, pay out refunds and hire additional auditors, so that audit programs may be expanded or contracted depending upon their relative productivity, without requesting new appropriations. Taxpayers as well as the State Tax Commissioner should be authorized to round off all figures to the nearest dollar, to save internal processing costs.

10. That a Tax Policy and Advisory Group be created, consisting of tax practitioners, tax administrators, and distinguished lay citizens, responsible for reporting on changing revenue needs, recommending new tax legislation, and drafting bills.

11. That refunds be made directly by the State Tax Commissioner, without the cumbersome procedure of having them certified and paid by the Comptroller.

12. That the sales and use tax be called by that name in the statutes.

Codification of the State's Tax Laws Into A Connecticut Revenue Code

This portion of the Commission's report is primarily concerned with procedural and administrative matters. **It recommends major revisions in tax procedure, including a logical rearrangement of all tax procedure statutes.** Major substantive amendments, recommended elsewhere by the Commission, together with the procedural changes recommended here, should be compiled along with all other tax laws into a Connecticut Revenue Code. This should cover all State taxes, including death taxes and local property taxes. But the latter should continue to be administered by the towns.

Such a code would be a revision and reorganization of the present Title 12 of the Connecticut General Statutes. It should be published in looseleaf form, with periodic supplements and revisions, both during and immediately after each legislative session. The binder containing it could also contain regulations, regularly supplemented as they are revised by the State Tax Commissioner. Annotations of court decisions, Chief Counsel's opinions, rulings and pertinent law review articles could also be included, along with histories of repealed and amended sections, plus cross references and an index.

Some Problems Caused by the Administrative Procedure Act

Capital Gains and Dividends Tax

Conflicts between the Administrative Procedure Act and the Capital Gains and Dividends Tax exist over procedure in tax disputes. It is not clear which law should prevail. The Administrative Procedure Act was approved July 15, 1971, to take effect January 1, 1972. Section 20 repealed all provisions in the General Statutes inconsistent with the Act. However, the Capital Gains and Dividends Tax[5] was enacted August 23, 1971,

effective August 15, 1971. This was after passage of the Administrative Procedure Act, but before the latter's effective date.

When a capital gains or dividends tax refund claim is denied, it is not clear whether or not a hearing is required. Section 12-521 of the tax law provides for an appeal from the State Tax Commissioner to the Hartford County Superior Court, while Section 4-183(b) of the Administrative Procedure Act requires use of the Court of Common Pleas. Additional confusion is caused by a sentence in Section 4-183(a) which says that the judicial review available under other laws is not limited by the Act. Does this mean that a taxpayer may choose his forum? Neither the Court Reorganization Act of the 1971 Legislature[6] nor the technical amendments made to it, when the 1972 Legislature tried to remedy some of its inconsistencies, cleared up this problem.[7]

Miscellaneous Inconsistent Tax Appeals Laws

The forum for appeals under section 12-544 of the Admissions and Club Dues Tax was changed from the Superior to the Common Pleas Court, effective September 1, 1972. Section 12-268(i) of the tax law also now requires that appeals in utility tax cases be made to the Court of Common Pleas instead of the Superior Court. But section 12-312 still permits appeals in cigarette tax disputes to be made to the Superior Court, although corporation[8], gasoline[9], insurance[10], and sales taxes[11] are all appealable to the Court of Common Pleas. See Appendix B for Chart, Summary of Appeals Procedures for Taxpayers other than Appeals under the Administrative Procedure Act.

The Sales Tax

The sales tax, the State's largest revenue source, produced $358.6 million in fiscal 1972. About 70,000 retailers hold sales tax permits; returns from them are due quarterly, followed by payment at the end of the month following each quarter. There are about 3,500 delinquent sales tax payments each quarter. One of the most effective collection methods is the threat to suspend a delinquent taxpayer's permit to continue in business.

The present procedure for suspending or revoking a sales tax permit, under section 12-409(6), where a retailer fails to pay over the tax, is theoretically affected by the Administrative Procedure Act. The latter has set up certain overlapping procedures, principally dealing with notification requirements,[12] which could result in delaying collection of sales taxes already paid to a delinquent retailer by his customers. The longer the delay, the greater the possibility that the bankruptcy or removal from the jurisdiction of the retailer could place collection of some of these taxes in jeopardy.

Previously, out of the approximate 3,500 delinquent sales taxpayers each quarter, only about 180 have been threatened with suspension of their permits. Only about 30 of these have actually had their permits suspended. It would be unwise to permit the Administrative Procedure Act to create additional collection problems, since there is a large potential revenue loss involved. In fiscal 1969, 257 accounts amounting to $261,899.37 were written off, 93 accounts amounting to $126,400.42 in fiscal 1970, and 46 accounts amounting to $83,481.91 in fiscal 1971. Although there has been a noticeable improvement, the higher current rate of the sales tax will inevitably result in a future rise in these figures.

Cigarettes and Liquor

Similar problems, albeit of lesser magnitude, exist with cigarette tax licenses (in policing contraband sales)and liquor dealers' licenses (with respect to the payment of liquor taxes).

Jeopardy Assessments

The seldom-used section 12-417 jeopardy assessment procedure is designed to enable the Commissioner to make an immediate assessment of any tax where he believes its collection will be jeopardized by delay. This appears to conflict with the section 4-177 contested case hearing procedure of the Administrative Procedure Act.

Great Public Interest in Tax Procedure

The collection of taxes and the procedures concerning them are of greater public interest than many other administrative procedures. They are also sufficiently unique so as to justify procedure specially designed to deal with tax collections, rather than trying to bend tax collection procedures to fit in the mold of procedure generally applicable to other agencies.

Of the 14 states and the District of Columbia that have adopted the Uniform Administrative Procedure Act or similar laws,[13] 4 of them exempt the Tax Department from that statute[14] and 2 of them do not apply it to appeal procedures.[15]

Uniform Tax Procedure

The State Tax Commissioner should be exempted from the Administrative Procedure Act. But a comprehensive and uniform tax procedure code should be enacted instead. Some provisions would resemble portions of the Administrative Procedure Act. Codifying and unifying tax procedure in a consistent manner will protect taxpayers by clearly setting forth their obligations and duties and by establishing a simple procedure for appeal from any decision made at any level of the tax department. It will also facilitate the collection of taxes by the State of Connecticut.

Conflicting Provisions

Apart from problems caused by the Administrative Procedure Act, *there are many conflicting and inconsistent procedural and administrative provisions in the tax laws.* For example, all funds received by the Tax Commissioner from the corporation business tax are to be recorded with the Comptroller and deposited daily with the State Treasurer.[16] But this depositary requirement appears to stand by itself, since there is apparently no comparable provision governing other taxes.

Some of the tax laws give the Commissioner power to conduct any inquiry, investigation or hearing, take sworn testimony, subpoena witnesses, and require the production of books, papers and pertinent documents.[17] Other statutes do not specifically have these provisions. Not all of the State's tax laws impose liability on a purchaser of a business to insure that all of the seller's tax liabilities are met or that a sufficient amount be withheld from the purchase price to meet them.

Some procedural provisions specify a number of days within which the Commissioner or the taxpayer must take certain action, while others use vague language such as "forthwith," "as soon as practicable," etc. In some cases, the Tax Commissioner is permitted to issue rules and regulations for a given tax,[18] while other tax laws are silent on this point. Some tax laws provide for a lien, while others do not. Even Section 12-35, the general tax collection statute, has no lien provision.

This section gives the State agency responsible for collecting a particular tax the power to add such penalty or interest or both, as prescibed by law, if the tax is not paid within 30 days from its due date. Interest shall not be less than three-quarters of 1% per month (except under the inheritance tax), but if there is no specific statutory penalty, one in the amount of 10% of the whole or such part of the principal of the tax as is unpaid may be added. If no interest is specified, interest at the rate of 1% of the whole or such part of the principal of the tax as is unpaid for each month or fraction thereof may be added.

These overriding interest and penalty provisions exemplify the way the tax laws have been enacted piecemeal, frequently hurriedly copied from the laws of another state during the close of our legislative sessions. As a result, *Connecticut's tax system is essentially an overlay of uncoordinated provisions, passed at different times without regard to their effect on existing law.*

Procedures have developed over many years. Twenty years ago Connecticut's tax collections were only about $127 million. Only 4 tax sources yielded more than $10 million apiece. The procedures used then are totally inadequate today, when total tax collections have reached the billion dollar mark and 3 tax sources alone yield amounts in the hundreds of millions of dollars.

Federal Type of Tax Procedures

While a broadly based personal income tax is not being recommended by the Commission, *considerable improvement can and should be made to the administration and collection of the capital gains and other taxes.* The Internal Revenue Service has had the most extensive experience of any United States tax authorities in collecting and administering various different types of taxes. Its procedures have been developed gradually since 1913. Their statutory authorization is set forth in the Federal Internal Revenue Code.

To the extent that the Federal procedures are adaptable to the collection and administration of existing Connecticut taxes, they should be made part of an internally consistent tax procedure and administration code. This should supplant all existing procedural and administrative provisions (except death tax ones). It should set forth in logical order all the State Tax Commissioner's powers and duties with respect to the assessment, collection and administration of taxes, and the imposition of interest, penalties, and liens for un-

paid taxes. Liens should be general ones on all property of the taxpayer, to be filed both in the town clerk's office (real estate liens) and with the Secretary of State (all other liens).

The all-important administrative appeals provisions, governing the handling of refund claims and the rights of taxpayers objecting to a decision made by any level of the tax department, should be revised. Initially, a taxpayer should have the right to a conference with the person examining his return or refund claim. This should be followed by an opportunity to meet with someone at a higher level, such as the chief of that particular tax division or his assistant.

Informal Appeal to the State Tax Commissioner

Thereafter, there should be a right to an informal appeal to the Commissioner or his delegate. This procedure exists now under the corporation business tax. The Commissioner or his delegate could consult the Chief Counsel as to costs and hazards of litigation. A procedure similar to the contested case provisions in Sections 4-177, 4-178 and 4-180 of the Administrative Procedure Act, dealing with the requirements of a written record, the taking of evidence, and the requirement of written notification of a decision should apply to these appeals. Costs to the taxpayer should be minimized. He should only incur professional fees if he retains a lawyer or accountant to assist him.

Strike Force Recommendations

The Tax Sub-Committee of the Governor's Strike Force on Full Employment made an extensive study of tax procedure, recommending the adoption, with certain modifications, of Federal procedures, in line with the way such procedure has been adopted by other states and in model state income tax statutes. These recommendations were embodied in the proposed bill submitted by the Strike Force and should be examined and considered during the drafting of any new procedural provisions.[19]

Tax Litigation

Death Tax Appeals

Death tax appeals are still made to the Probate Courts,[20] with an appeal from them in the form of a trial *de novo* in the Superior Courts (although the Administrative Procedure Act appears to require use of the Hartford County Court of Common Pleas instead of the Probate Courts).[21]

Other State Tax Appeals

Other tax appeals are not made either to the Superior Court or the Court of Common Pleas, in most cases limited to the courts in Hartford County, rather than the county in which the appellant is located. (See Appendix B, Summary of Appeal Provisions Other than Those in the Administrative Procedure Act.)

Determining Possible Need for a State Tax Court

The present uncertainties caused by conflict in the statutes as to which court is to hear appeals from the State Tax Commissioner must be resolved, but whether or not a special Tax Court should be created to hear these appeals cannot be determined until a study is made of the volume and nature of tax appeals.

Valuation and Condemnation Appeals

Appeals in property tax valuation disputes from the town assessors are initially to the local Board of Tax Review. Thereafter, they go to the Court of Common Pleas, which usually refers them to a referee, following a hearing on the short calendar. Condemnation proceedings are brought by agencies of the State, the towns or public utilities. Appeals in such valuation disputes go through a similar referral procedure in the Superior Court. The Commission has recommended in Vol. II, Part C, that the Boards of Tax Review be replaced by 6 Regional Boards of Appeal, consisting of professional valuation experts. There would still be an appeal to the courts from them.

An improvement could be made to the referral system of all appeals to reduce the short calendar

load of the Courts of Common Pleas (in the case of property tax assessment appeals) and the Superior Courts (in the case of condemnation appeals). This could be done either by changing the rules of these courts or by statute. It would involve automatic referral of valuation cases to one or more referees, as under the present system. But the cases would not have to be docketed and heard on the short calendar.

Elimination of Service of Process by Sheriffs

At present, State tax litigation must be commenced in the same way as most other civil suits, by obtaining a Sheriff to serve pleadings on the State Tax Commissioner or his delegate and making a return to the appropriate court. This wastes both time and money. Section 86 of the Strike Force bill provided that **all litigation should be commenced by filing the appeal petition in person or by registered or certified mail with the court possessing jurisdiction,** with a copy thereof filed in the same manner with the State Tax Commissioner. Thereafter, the court would notify both taxpayer and Tax Commissioner of the time and place of hearing. This is somewhat like the rules governing commencement of a suit in the Tax Court of the United States and should be adopted for all Connecticut tax litigation.

Chief Counsel to the Tax Commissioner

Need for a Chief Counsel

At present, the State Tax Commissioner employs lawyers as Inheritance Tax Attorneys. They deal with all legal questions concerning administration of the death tax laws. There is also one other attorney doing general legal work in the tax department. But some of the increasingly important taxes, such as the one on capital gains and dividends, have no tax department attorneys directly involved in their enforcement.

The Attorney General's Office is at present the legal arm of the State Tax Commissioner. But this work could be handled more efficiently if all the lawyers representing the State Tax Commissioner were in his department. In addition, many other legal services of value to the State and the taxpayers, some of which are not offered at all now, could be handled best by tax department lawyers.

Establishment of Office of Chief Counsel to the Tax Commissioner

Just as the Federal Commissioner of Internal Revenue has a Chief Counsel and a staff of lawyers working with him, so the State Tax Commissioner should be given similar assistance. He should be empowered to appoint a Chief Counsel. Then, all legal problems affecting taxes would be transferred from the Attorney General to the Chief Counsel, easing the former's workload and providing an increased opportunity to develop expertise in dealing with State tax law questions.

Many existing arrangements could nonetheless be continued. Those attorneys presently handling tax litigation in the Attorney General's Office or working in the State Tax Commissioner's Office (other than as Inheritance Tax Attorneys, their supervisor or as First Assistant Tax Commissioner) could form the nucleus of the legal staff for the Chief Counsel's Office. One of them could be considered for appointment as Chief Counsel.

The Chief Counsel to the Tax Commissioner would be responsible for all legal questions affecting taxes (except death taxes) collected by the State Tax Commissioner. Thus, he would handle litigation, issue legal opinions to the State Tax Commissioner at the latter's request, review proposed tax regulations, help prepare rulings to be issued to taxpayers by the Commissioner, and, if so requested, advise the Commissioner or his delegate as to the hazards and costs of litigating a given issue.

The present research section of the tax department should be expanded and placed under the new Chief Counsel.

Penalties, Criminal Sanctions, and Interest

Differing Penalty Provisions

There is no consistent pattern in imposing penalities for late filing or failure to file tax returns. For example, the liquor tax has a 2% per month penalty,[22] under the admissions tax the penalty is $10 plus 10% of the tax,[23] it is $25 plus 10% under the dividends and capital gains tax,[24] and $25 plus 25% (but not less than $50) under the corporation tax.[25]

There is also inconsistency as to whether or not the penalties are mandatory or discretionary. Penalties under the liquor and corporation taxes are mandatory. The Commissioner may abate or remit the whole or any part of any admissions tax penalty, if satisfied that failure to comply was due to reasonable cause. But under the dividends and capital gains tax, the Commissioner must be satisfied beyond a reasonable doubt that the failure to file and pay was due to reasonable cause and was not intentional or due to neglect.[26] The penalty for a deficiency of tax on dividends or capital gains may be waived only if the Commissioner is satisfied that the deficiency was not deliberate or due to fraud or evasion.[27]

There is no apparent justification for the lack of uniformity as to the nature, amount, and Commissioner's discretion with respect to penalties. Sound tax policy should give the Commissioner power to waive all or any portion of any penalty, according to standards set forth in regulations promulgated by the Commissioner. Furthermore, the amount of the penalties could be uniformly set at the greater of $10 or 10% of the amount of the tax due for all taxes except death taxes. The penalty would apply where the return is filed late or the tax paid late, but **there should be no penalty on a deficiency, except for one resulting from the filing of a false, fraudulent, or negligently prepared return.**

Criminal Sanctions

Appendix C sets forth the criminal sanctions for violations of State tax laws. These vary from 60 days to up to one year in jail. Whether or not there should be uniform criminal penalties for violation of the tax laws should be studied further, since some violations are more serious than others. Obviously, filing a false or fraudulent return is more serious than failure to file a return or failure to testify upon a subpoena.

Interest

Interest on unpaid corporate taxes is ¾% per month,[28] but only ½% per month is paid on refunds.[29] Interest is imposed on tax deficiencies under the dividends and capital gains tax at 1% per month,[30] but no interest may be paid on refunds, unless the refund is ordered by a court. Then the rate is only 6% per annum.[31]

There is no valid reason for having interest on deficiencies at a higher rate than interest on refunds. The Federal Internal Revenue Code prescribes a uniform rate of 6%.[32] While deficiencies should bear interest from the due date of the tax payments, the State Tax Commissioner needs a grace period to process refund claims and returns calling for refunds. Such a period will also act as a deterrent to taxpayers making deliberate overpayments to receive interest on their surplus funds. No interest should be paid until after the filing of a refund claim, rather than have the interest run from the date of overpayment. Therefore, refunds should bear interest from a period commencing 60 days after a claim (including a return showing an overpayment) is filed, whether or not the ultimate determination that an overpayment has been made is by a court.

Interest rates fluctuate. Setting them too low might encourage taxpayers to underpay their tax, because they could receive a higher rate elsewhere, while rates that are too high would tempt taxpayers to overpay, if they had excess funds that could not earn as much elsewhere. A technical argument can be made for a differential between the rates on deficiencies and those on refunds, with the interest on deficiencies higher than that on refunds so as to discourage manipulation by the taxpayers. But this has not proven to be a serious problem under the Internal Revenue Code with its 6% rate on both deficiencies and refunds. By delaying the period during which interest accrues (as suggested above), the problem is minimized even more. **Furthermore, the Tax Commissioner should be required to recommend to the Legislature, at the start of each session, whether or not the rate should be changed.**

Audits

Selection of Sales Tax Accounts for Audit

As presently staffed, the State Tax Commissioner is only able to audit about 1,400 sales tax accounts annually. Each auditor obtains about $80,000 additional taxes. However, there are over 70,000 accounts. Therefore, selection for audit of those returns that will be the most productive of additional revenue has always been a problem.

California has been using an electronic selection system to identify accounts for sales tax audits. The Internal Revenue Service uses a sophisticated discriminate function, based upon an aggregation of audit characteristics of income tax returns. This is programmed into the computers used to select income tax returns for audit.

It is recommended that a system similar to the California sales tax audit selection one be put into operation in Connecticut, with the necessary appropriations to expand staff and acquire equipment, so that this State will be able to be more effective in enforcing its sales tax laws, collecting more of what is legally due it and, by so doing, more than pay for the additional costs of collection.

Retention of a Computer by the State Tax Commissioner

The State Tax Commissioner presently has a Burroughs 2500 computer. This is being used in an increasingly effective manner to facilitate administration and auditing procedures affecting many state taxes, particularly those on corporations, sales, and capital gains. In fact, it will no longer be necessary for the State Tax Commissioner to audit Federal income tax returns in the I.R.S.'s computer center in Andover, Massachusetts, since the tapes of Connecticut residents' Federal returns can now be processed by the Connecticut computer. This assumes that the tax on dividends is repealed, as recommended by the Commission in Part A of this volume. The State Tax Commissioner estimates that he will be using this computer approximately 50 or 60 hours weekly, in double shifts.

There are proposals to consolidate most or all of the computer work for the State of Connecticut into a computer center. While these proposals will no doubt improve efficiency in many departments, time sharing on such a system by the State Tax Commissioner would be counterproductive, because of the loss of control of priorities and the occasional delays that will occur in obtaining access to the center. **Therefore, the efficient operation of the State Tax Commissioner will be greatly enhanced if the present computer can be retained in his department.**

Death Tax Audits

Under both the old and new death tax procedures, succession tax returns are initially audited by Inheritance Tax Attorneys, who deal with substantive issues of tax law regarding inclusion of various items in the gross estate and valuation of property. Once all these issues have been resolved between the Inheritance Tax Attorney and the fiduciary or his counsel, the tax return is processed by a computation section. This audits the claimed deductions to determine if they are both legally valid and reasonable in amount. Then it computes the inheritance tax.

Even before the speed-up in death tax procedure temporarily overloaded the computation section, during a 6 month transition period, computation of the succession tax was taking 4 or more months after all issues as to inclusion of property and questions of valuation had been resolved with the Inheritance Tax Attorney. As a result of these delays, probate accounts could not be filed, distribution of estates were delayed, and many lay fiduciaries and estate beneficiaries either unfairly blamed their attorneys, found the delays incomprehensible, or both.

Besides the frustration and ill-will caused by the delays, real financial loss occasionally occurs. Some examples of the losses caused by these delays are the cost of intermediate probate accounts to make distributions carrying out post mortem tax plans or the abandonment of those plans and occasional delays in paying fiduciary commissions and attorney's fees, where for either tax reasons or client's desires they could not be paid until final distribution of the estate.

The problem causing the delays in the computation process is the unavailability of enough trained people in the computation section. Only additional appropriations of funds to enable the

State Tax Commissioner to hire and train more people for the computation section can solve this problem. **Sufficient funds should be appropriated to augment the staff of the computation section to speed up the processing of inheritance tax returns.**

Revolving Audit Fund

In some states, there is a revolving audit fund into which all additional assessments are deposited. From it all refunds are paid and funds are used to pay additional auditors. Thus, so long as high audit productivity lasts, the Tax Departments of these states are able to hire additional auditors, without requesting special appropriations from the Legislature each time one is needed. At the end of some predetermined period, such as the quarter or the full year, the fund is reduced to a specified amount, and the excess turned over to the State Treasurer.

Accordingly, establishment of a revolving audit fund under the control of the State Tax Commissioner is recommended to enable him to expand his audit program for the more intensive audit activity that new taxes and higher rates will demand in the future.

Rounding Off to the Nearest Dollar

Under the Internal Revenue Code, taxpayers may choose to round of all amounts reported on their returns to the nearest dollar. Whether or not taxpayers elect this option, **if the State Tax Commissioner were authorized to round off in his internal accounting work, regardless of how taxpayers report, some savings in processing costs will be realized.**

Tax Policy and Advisory Group

Need for a Continuing Legislative Study Group

Some states, such as New Jersey, have permanent tax policy committees charged with keeping abreast of the state's needs with respect to state and local taxation. Here in Connecticut, there have been several different tax studies (including the present one) made in the last 5 years, each of them starting all over again and none of them, up until now, having their recommendations enacted.

The technical quality of substantive Connecticut tax legislation enacted since 1969 has been poor, resulting in many uncertainties for taxpayers as to the existence, nature, and extent of their liabilities, causing many problems in the administration of the tax laws and an extensive amount of litigation on questions that better legal draftsmanship would have avoided.

Therefore, **the Commission recommends appointment by the Governor of a Tax Policy and Advisory Group.** It should be composed of tax practitioners (lawyers and certified public accountants practicing tax law or tax accounting), tax administrators (supervisory employees of the State and local tax systems, to the extent the conflict of interest laws do not prevent State employees from serving) and distinguished lay citizens (in private business, organized labor, and the professions). **Funds should be made available to it to hire legal counsel, economists, and other consultants.**

The Group would be responsible for tax policy. It would keep abreast of the State's changing economic picture, needs for additional revenues, and the effectiveness of existing tax laws. *A report on these subjects, coupled with recommendations for tax legislation and fully drafted bills appended, would be presented to both the Governor and the Chairmen of the Joint Finance Committee of the Legislature within a specified period prior to the opening of each annual legislative session.* In addition, the Group would be available for drafting assistance on all bills about to be favorably reported from the Joint Finance Committee, as well as any tax bills or amendments to tax bills that did not originate in that Committee, but have been enacted by one House of the Legislature and are pending in the other House.

Call the Sales and Use Tax by That Name

The Sales and Use Tax is officially known as the Education, Welfare and Public Health Tax. This cumbersome and obsolete name should be replaced and the tax called the Sales and Use Tax.

APPENDIX A:

Summary of Liens for State Taxes in Connecticut

	Lien Summary	
	Section	Property Subject to Lien
Chapter 207 Insurance Companies	12-204	Real Estate
Chapter 208 Corporation Business Tax	12-235	Real Estate
Chapter 209 Air Carriers	12-235; 12-248	Real Estate
Chapter 210 Railroad Companies	12-253	All property on which tax is laid
Chapter 211 Express, Telegraph, Telephone, Cable and Car Companies	12-268h	Real Estate
Chapter 212 Water, Gas, Electric and Power Companies	12-268h	Real Estate
Chapter 214 Cigarette Taxes	No lien	—
Chapter 216 Succession and Transfer	12-366	Real Estate
Chapter 219 Education, Welfare and Public Health Tax (Sales and Use Tax)	12-420	Real Estate
Chapter 220 Taxation of Alcoholic Beverages	12-441	All property used in business
Chapter 221 Gasoline and Special Fuel Taxes	No lien	—
Chapter 222 Motor Carrier Road Tax	No lien	—
Chapter 223 Real Estate Conveyance Tax	No lien deeds not recorded unless tax paid	—
Chapter 224 Capital Gains Tax	12-512	Real Estate
Chapter 225 Admissions and Club Dues Tax	No lien	—

APPENDIX B

Summary of Appeals Procedures for Taxpayers, Other Than Appeals Under the Administrative Procedure Act

(The conflicts with the Administrative Procedure Act are not shown)

	APPEALS TO TAX COMMISSIONER			APPEALS TO COURT		
	Section	Time Limit	Comments	Section	Time Limit	Court
Chapter 201 Tax Commissioner (General Provisions applicable to towns and companies)	No Provision			12-33	One month from decision	Superior Court of county in which applicant is located
				Scope: Uncertain. State provides any town or company aggrieved by action of the commissioner may . . . appeal.		
Chapter 207 Insurance Companies	No Provision			12-208	One month from time for payment	Common Pleas Court, Hartford County
Chapter 208 Corporation Business Tax	12-236	Thirty days after notice delivered or mailed to taxpayer		12-237	One month from service of notice	Common Pleas Court, Hartford County
Chapter 209 Air Carriers	12-236	Thirty days after notice delivered or mailed to taxpayer		12-237	One month from service of notice	Common Pleas Court, Hartford County
Chapter 210 Railroad Companies	12-252	Ten days after notification		12-33	One month from decision	Superior Court of county in which located (application of this statute is uncertain)
Chapter 211 Express, Telegraph, Telephone, Cable, and Car Companies	12-268(i)	Thirty days after notice		12-268(l)	One month after service of notice	Common Pleas Court, Hartford County
Chapter 212 Water, Gas, Electric and Power Companies	12-268(i)	Thirty days after notice		12-268(l)	One month after service of notice	Common Pleas Court, Hartford County
Chapter 214 Cigarette Taxes	12-311	Ten days after notice		12-312	No time limit	Superior Court Hartford County
Chapter 216 Succession and Transfer	12-359(b)	—		12-359(b)	—	Probate Court for Probate District of Decedent's Domicile
Chapter 217 Estate Tax	—	—		12-394	Sixty days from receipt of notice	Common Pleas Court, Hartford County

APPENDIX B (Cont.)

Summary of Appeals Procedures for Taxpayers, Other Than Appeals Under the Administrative Procedure Act

	APPEALS TO TAX COMMISSIONER			APPEALS TO COURT		
	Section	Time Limit	Comments	Section	Time Limit	Court
Chapter 219 Education, Welfare and Public Health Tax (Sales and Use Tax)	12-418(l)	Thirty days after assessment		12-422	One month from notice	Common Pleas Court, Hartford County
	12-421	Thirty days after notice of action	Prepayment required			
Chapter 220 Taxation of Alcoholic Beverages	12-447	Ten days after mailing of notice		12-448	One month from time provided for payment	Common Pleas Court, Hartford County
				12-454(c)	Fourteen days after decision re seized goods	Common Pleas Court, Hartford County
Chapter 221 Gasoline and Special Fuel Taxes	No General provision for hearing			12-461	Ninety days from time of payment	Common Pleas Court, Hartford County
	12-470	No time specified	Limited to situation where commissioner fixes amount of tax	12-463	Thirty days after revocation of license	Common Pleas Court, Hartford County
Chapter 221 Gasoline and Special Fuel Taxes (cont'd)	12-475(a)	No time limit for taxpayer. Commissioner after request must set hearing within five days	Limited to review of new regulations	12-475(a)	No time limit for review of decision on new regulations	Court of Common Pleas (County unspecified)
Chapter 222 Motor Carrier Road Tax	12-480(b)	No specific time limit on request for hearing	Limited to claims for refund	12-489	No time limit	Common Pleas Court, Hartford County
Chapter 223 Real Estate Conveyance Tax	No appeal provisions			No appeal provisions		
Chapter 224 Capital Gains Tax	12-521	Thirty days after notice is mailed or delivered		12-522	One month after service of notice of decision	Superior Court Hartford County
Chapter 225 Admissions and Club Dues Tax	12-553	Thirty days after notice is mailed or delivered		12-554	One month	Common Pleas Court, Hartford County

APPENDIX C:

Criminal Sanction for Violations of State Tax Laws

	Section	Penalty
Chapter 207 Insurance Companies	None	
Chapter 208 Corporation Business Tax	12-232	Up to sixty days for failure to testify upon subpoena
Chapter 209 Air Carriers	None	
Chapter 210 Railroad Companies	12-31	Up to six months for false statements
Chapter 211 Express, Telegraph, Telephone, Cable and Car Companies	12-268f	Up to sixty days jail for failure to testify upon subpoena
Chapter 212 Water, Gas, Electric and Power Companies	12-268f	Up to sixty days jail for failure to testify upon subpoena
Chapter 214 Cigarette Taxes	12-308	Use of fraudulent cigarette stamps
	12-310	Up to sixty days jail for failure to testify upon subpoena
	12-321	Up to one year for any violation of statutes
Chapter 216 Succession and Transfer	12-383	Up to one year for false return or affidavit
Chapter 217 Estate Tax	None	
Chapter 219 Education, Welfare and Health Tax (Sales and Use Tax)	12-428	Thirty days to one year for violation of Chapter
	12-429	Up to sixty days jail for failure to testify upon subpoena

APPENDIX C: (Cont.)

Criminal Sanction for Violations of State Tax Laws

	Section	Penalty
Chapter 220 Taxation of Alcoholic Beverages	12-445	Up to sixty days jail for failure to testify upon subpoena
	12-452	Up to six months for violation of Chapter
Chapter 221 Gasoline and Special Fuel Taxes	12-459	Up to six months for false or fraudulent claim for refund
Chapter 222 Motor Carrier Road Tax	12-482	Up to six months for false statement to obtain credit
Chapter 223 Real Estate and Conveyance Tax	None	
Chapter 224 Capital Gains Tax	12-510	Up to sixty days jail for failure to testify upon subpoena
	12-519	Up to one year for willful violation of chapter
Chapter 225 Admissions and Club Dues Tax	12-547 and 12-551	Up to one year for willful violation of Chapter (Class A misdemeanor)

FOOTNOTES TO PART C

1 See Vol. III, Parts A & B. All statistics in this part were supplied by the State Tax Commissioner.

2 P.A. 854 of the 1971 General Assembly, effective January 1, 1972, Connecticut General Statutes, Secs. 4-166 through 4-185 (Supp. 1972), applies to all agencies and agency proceedings not expressly exempted. The State Tax Commissioner is *not* exempt.

3 P.A. 863, of the 1971 General Assembly, The Succession Tax Procedure Act of 1971, amending Conn. Gen. Stat. Secs. 12-350, 352, 355, 358, 359, 365, 367, 373, 376, 376a, 378, 388, and 45-202 (Supp. 1972), repealing Secs. 12-360, 361, 362, and 368; P.A. 5, June Sp. Sess. 1971, Secs. 118-121, which accelerated filing and payment dates, bringing them in line with newly revised Federal estate tax procedure; and P.A. 265 of the 1972 General Assembly, making retroactive technical amendments to Secs. 12-349, 12-350, 12-358, 12-359, 12-367, and 12-376 of the Succession Tax Procedure Act of 1971.

4 Receipts for Connecticut taxes in fiscal year ending June 30, 1972 were:

Name of Tax	*Collected by*	*Amount*
Admissions	State Tax Commissioner	$ 7,033,205
Advertising Signs	State Police Commissioner	32,022
Alcoholic Beverages	State Tax Commissioner	24,109,393
Capital Gains & Dividends (before court ordered refunds)	State Tax Commissioner	60,968,226
Cigarette	State Tax Commissioner	68,136,401
Corporate Business	State Tax Commissioner	122,948,233
Electric & Power Companies	State Tax Commissioner	4,553,168
Estate	State Tax Commissioner	175,908
Express Companies	State Tax Commissioner	2,127
Foreign Insurance Companies	Insurance Commissioner	15,621,182
Gas Companies	State Tax Commissioner	3,450,664
Gas, Electric & Steam Companies	State Tax Commissioner	16,221,659
Gasoline & Special Fuel, Including Motor Carrier Road Tax	State Tax Commissioner	130,437,579
Inheritance	State Tax Commissioner	49,743,449
Insurance Co. (domestic) Interest and Dividends	Insurance Commissioner	18,902,747
Insurance Co. (domestic) Premiums	Insurance Commissioner	15,456,210
Liquor Permit Fees	Liquor Control Commission	4,312,687
Motor Vehicle Registration & Operators' Licenses Fees	Commissioner of Motor Vehicles	43,247,150
Occupation	State Tax Commissioner	119,700
Property Taxes	Towns	919,600,000*
Railroad Car Companies	State Tax Commissioner	11,645
Sales and Use	State Tax Commissioner	358,630,216
Self Insurance Premiums	State Tax Commissioner	42,100
Telephone Companies	State Tax Commissioner	26,644,513
Telegraph & Cable Companies	State Tax Commissioner	28,811
Unauthorized Insurers Premium	Insurance Commissioner	1,245
Water & Water Power Companies	State Tax Commissioner	1,964,827

*Estimate. Collections for fiscal year ending June 30, 1971 were $874,200,000.

5 P.A. 8, Conn. Gen. Ass. Aug. Sess., revising Chapter 224.

6 P.A. 870, 1971 Conn. Gen. Ass.

7 An Act Making Technical Amendments to the Court Reorganization Bill, P.A. 108, Sec. 1, Conn. Gen. Ass., Feb. 1972.

8 Section 12-237.

9 Section 12-461.

10 Section 12-208.

11 Section 12-422.

12 Section 4-166(2) of the Administrative Procedure Act considers this to be a contested case, Sec. 4-177(a) requires an opportunity for hearing after reasonable notice, Sec. 4-180 requires personal or mail notice of a final decision or order and Sec. 4-182(c) requires that the suspension or revocation of a license be preceded by notice by mail to the licensee of facts or conduct which warrant the intended action and that the licensee have an opportunity to show compliance with all lawful requirements for retention of his license.

13 Arkansas, Connecticut, Georgia, Hawaii, Louisiana, Maryland, Michigan, Missouri, Oklahoma, Oregon, Rhode Island, Washington, West Virginia, and Wyoming.

14 Louisiana, Maryland, Michigan, and Oklahoma.

15 The District of Columbia exempts its Tax Court, and Washington exempts its Board of Tax Appeals.

16 Section 12-234.

17 Sections 12-510(d) (capital gains and dividends tax), 12-445 (liquor tax), 12-552(c) (admissions tax).

18 For example, Sec. 12-518 of the capital gains and dividends tax.

19 While the procedure in the Strike Force Bill was designed to deal with the gross income tax recommended by the Strike Force, some of the provisions can be adopted to existing tax procedures. They appear in Sections 40 through 115. The heart of the generally applicable procedure and administration provisions are contained in Secs. 59 through 113.

20 Section 12-359(b).

21 Section 45-288. In light of Secs. 20 and 4-183(a) of the Administrative Procedure Act, the Sec. 12-359(b) requirement of appeals to the probate court may have been nullified.

22 Section 12-439(a).

23 Section 12-547.

24 Section 12-509.

25 Section 12-229.

26 Section 12-509.

27 Section 12-511(a).

28 Section 12-225.

29 Section 12-227.

30 Section 12-509.

31 Section 12-522.

32 I.R.C. Sec. 6601(a) on tax deficiencies and Sec. 6611(a) on overpayments of tax.

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